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CURRENT ECONOMIC AND FINANCIAL CONDITIONS

By the Staff
Board of Governors
of the Federal Reserve System

October 2, 1968

SUMMARY AND OUTLOOK

Outlook for economic activity

A slower pace of economic activity is expected to continue through the balance of the year, although it now appears likely to be much less of a reduction from earlier this year than was projected when the surtax was enacted. In the final two quarters, real expansion in the economy is likely to drop to about half the 6 per cent rate of the first half. The fourth quarter gain in GNP is expected to be about the same as in the third quarter, with inventory accumulation rising but all the components of final demand (except residential construction), are expected to show a less vigorous performance than in the third.

Consumer buying, both of durables and nondurables, rose vigorously in July and was maintained at advanced levels in August and September. With expenditures strong and the rise in disposable income slowed considerably by the surtax, the rate of saving was sharply curtailed. In the fourth quarter, disposable income is expected to rise only moderately further and the rise in consumer spending should slow appreciably. Only modest increases are expected from other sectors of final demand. Federal spending and business capital outlays are both projected as levelling off, and residential construction expenditures should edge up.

The rate of inventory accumulation may rise, however, if businessmen maintain output schedules but consumption growth eases as projected. Price increases are likely to be only moderately below the first half rate and wage pressures show few signs of abatement.

Outlook for prices and resource use

The recent price situation has been characterized, on the one hand, by a slowing of the rise in the CPI--after allowing for usual seasonal changes in food prices and after excluding the temporary sharp spurt in mortgage interest charges--and, on the other, by a renewed pick-up in industrial prices. Retail food prices may edge up contra-seasonally this autumn, although the rise is expected to fall short of the increases last winter and early spring. The rise in service prices has also slackened moderately from the extraordinarily rapid rate in the early months of the year, and some further slowing--at least for medical care costs--is a possibility.

No let-up has occurred yet in the rapid increases in retail prices of non-food commodities. This autumn's price advance for new cars apparently falls short of last year's, and, with consumer demands generally expected to slacken in coming months, the advance in retail prices of non-food commodities may slow. However, the spurt in industrial commodity prices in September may renew upward pressures at the retail level.

Industrial production declined somewhat further in September because of the continued drop in steel output. The current steel rate--down nearly a third from July--is permitting a sizable run-off in steel inventories--and steel output may now be stabilizing. With auto output vigorous, the production index may rise modestly over the balance of the year from the current reduced level but significant slack in industrial capacity utilization would remain.

Employment is expected to rise less rapidly in the fourth quarter reflecting a probable employment dip in the industrial sector. The unemployment rate is projected to rise slowly toward 4 per cent from the 3-1/2 per cent rate in August.

Credit demands

Business credit demands are expected to remain moderate over the next few months. The small 1/4 percentage point reduction in the prime loan rate by most major banks is not expected to spark any surge in loan growth at banks. Corporate income tax payments in October and November will be relatively small by recent standards, though rising to above year-ago levels in December. But some acceleration in inventory rebuilding between now and year-end may sustain business loan expansion at around late summer rates.

Corporate bond volume is coming months is likely to remain around the current pace of three-quarters of a billion dollars per month. Such a volume is about half as much as the exceptionally high year ago rate, but still fairly substantial. The volume of public utility financing is expected to remain relatively large, and moderate-sized industrial companies appear to be floating issues at a somewhat increased pace, perhaps taking advantage of the opening offered by the paucity of large corporate borrowers in the market. There is no evidence yet of a significant return of large borrowers to the market: the liquidity position of corporations is no longer deteriorating; their cash flow appears comfortable relative to need; and bank funds are somewhat more readily available and slightly less expensive.

Municipal bond volume is likely to remain at the very rapid pace of recent months, reflecting both industrial revenue financing--which should decline sharply after late December--and the coincident marketing of several very large offerings currently on the docket. In the latter part of October, the U.S. Government will announce the refunding of maturing coupon issues ($5.5 billion of publicly held issues mature in November and December), and will likely be raising cash through the issuance of tax bills for payment during the second half of October and might also raise some cash in conjunction with the mid-November refunding.

The marketing of these U.S. Treasury and state and local government issues is likely to exert some upward pressure on yields in these areas, which under current market conditions appear low relative to high grade corporate issues, partly for expectational reasons. Upward yield movements on these issues might spread more widely, but forthcoming business news will be critical in determining interest rate trends.

Supply of f nds

The availability of funds for investment or lending by financial institutions is not expected to improve substantially further. Thus, developments on the supply side are not likely, in themselves, to lead to further interest rate declines.

In weeks immediately prior to the September tax period, banks appeared to have approached prevailing target levels for CD's, and the volume of these deposits outstanding leveled off. In view of the moderateness of the tax-period run-off, banks should be able to reattain late August peak levels of outstandings rather quickly. But thereafter, outstanding CD's are again expected to level off or show only relatively slow growth, assuming that loan demands will be moderate. The money supply, having declined on balance since mid-August, is expected to turn upward again and to continue to expand--though moderately--in the months immediately ahead.

Inflows of consumer-type time and savings deposits at commercial banks are expected to remain close to recent levels in the period immediately ahead, and inflows to thrift institutions are likely to show perhaps a limited improvement. The rate of personal saving is expected to continue near the reduced third quarter level, so that there is no substantial basis for expecting a significant expansion in the flow of consumer funds placed in financial assets. And the share flowing into banks or other financial institutions is not likely to rise much.

With savings inflows moderate, savings and loan associations and mutual savings banks may not become more aggressive during coming months in seeking out residential mortgage commitments. In line with these and related prospects, yields on residential mortgages appear likely to decline only to a limited extent in the fourth quarter from current record or near-record levels. Although a tendency toward lower mortgage yields will be reinforced by the usual drop in demands for residential mortgage credit during the fall, the reduction in credit demand probably will be less than seasonal in view of the continuing momentum of underlying demand for housing.

Balance of payments

Recent discussions of the U.S. payments problem have reflected a general expectation that the U.S. fiscal actions taken in June will produce a significant underlying improvement in the U.S. payments position in the months ahead. However, an inter-agency group of U.S. Government analysts, meeting last week to assess the outlook for the balance of payments, concluded that the prospective improvement will still leave a substantial problem ahead.

The liquidity deficit before special transactions, which diminished from $4.7 billion in 1967 to about a $3-1/2 billion annual rate in the first nine months of 1968, was projected to widen again in the fourth quarter, and to decline only to about $2-1/2 billion in 1969. This would be a disappointing outcome, given the assumption that 1969 will be a cyclically favorable year for the U.S. balance of payments, with little domestic growth during the first half year and continued expansion abroad.

The export surplus on goods and services was projected by the group to increase from a $2 billion annual rate in the first nine months of 1968 to about $4-1/4 billion in 1969. But it was thought that about half of this improvement might be offset by an adverse shift in private capital flows (excluding flows of foreign liquid funds). The recent reflow of U.S. bank credit is unlikely to continue; and inflows of foreign nonliquid private capital may diminish from their unprecedented 1968 levels.

On the official settlements basis, it seems likely that the surplus recorded thus far in 1968 will give way to renewed substantial deficit in 1969 as inflows of foreign liquid funds subside or may even be reversed. Some portion of such a deficit might be financed by U.K. debt repayments to this country and by a rebuilding of official dollar holdings by countries whose holdings were reduced in 1968. But it is also possible that 1969 will bring renewed gold losses and U.S. recourse to the IMF.

SELECTED DOMESTIC NONFINANCIAL DATA

(Seasonally adjusted)

	Latest Period	Amount: Latest Period	Amount: Preced'g Period	Amount: Year Ago	Per Cent Change: Year Ago*	Per Cent Change: 2 Yrs. Ago*
Civilian labor force (mil.)	Aug'68	78.7	79.0	77.6	1.4	3.5
Unemployment (mil.)	"	2.8	2.9	2.9	-5.9	-5.3
Unemployment (per cent)	"	3.5	3.7	3.8	--	--
Nonfarm employment, payroll (mil.)	"	68.4	68.2	66.2	3.4	6.2
Manufacturing	"	19.8	19.8	19.4	1.9	1.9
Other industrial	"	8.2	8.2	8.1	1.5	2.2
Nonindustrial	"	40.4	40.3	38.7	4.5	9.2
Industrial production (57-59=100)	"	164.0	165.6	158.1	3.7	3.9
Final products	"	164.8	164.7	158.2	4.2	5.6
Materials	"	163.0	167.0	157.9	3.2	2.4
Wholesale prices (57-59=100)1/	"	108.7	109.1	106.1	2.5	1.8
Industrial commodities (FR)	"	108.1	108.0	105.4	2.6	3.4
Sensitive materials (FR)	"	106.6	106.3	100.2	6.4	2.6
Farm products, foods & feeds	"	107.7	109.4	105.2	2.4	-3.2
Consumer prices (57-59=100)1/	"	121.9	121.5	116.9	4.3	7.1
Commodities except food	"	113.5	113.2	109.4	3.7	6.5
Food	"	120.5	120.0	116.6	3.3	4.1
Services	"	135.5	134.9	128.2	5.7	10.2
Hourly earnings, mfg. ($)	"	3.02	3.01	2.85	6.0	10.6
Weekly earnings, mfg. ($)	"	123.22	123.08	115.64	6.6	9.2
Personal income ($ bil.)2/	"	694.3	689.2	634.2	9.5	17.2
Corporate profits before tax ($ bil.)2/	QII'68	91.8	88.9	80.3	14.3	7.2
Retail sales, total ($ bil.)	Aug'68	29.2	29.1	26.4	10.4	14.0
Autos (million units)2/	"	8.6	9.1	7.0	22.5	4.0
GAF ($ bil.)	"	7.1	7.1	6.4	10.3	15.8
Selected leading indicators:						
Housing starts, pvt. (thous.)2/	"	1,508	1,532	1,407	7.2	36.1
Factory workweek (hours)	"	40.8	40.9	40.6	0.5	-1.5
New orders, dur. goods ($ bil.)	"	26.8	26.6	25.8	4.0	9.1
New orders, nonel. mach. ($ bil.)	"	47.7	49.2	4.5	6.6	19.8
Common stock prices (1941-43=10)	Sept'68	101.34	98.11	95.81	5.8	30.2
Manufacturers' Inventories, book val. ($ bil.)	Aug'68	86.9	85.8	81.9	6.1	16.3
Gross national product ($ bil.)2/	QII'68	852.9	831.2	780.2	9.3	15.2
Real GNP ($ bil., 1958 prices)2/	"	703.4	692.7	669.2	5.1	7.7

* Based on unrounded data. 1/ Not seasonally adjusted. 2/ Annual rates.

SELECTED DOMESTIC FINANCIAL DATA

	Week ended Sept. 28, 1968	4-week average	Last 6 months High	Last 6 months Low
Money Market 1/ (N.S.A.)				
Federal funds rate (per cent)	5.92	5.77	6.42	4.62
U.S. Treas. bills, 3-mo., yield (per cent)	5.12	5.19	5.82	4.96
U.S. Treas. bills, 1-yr., yield (per cent)	5.15	5.18	5.99	5.10
Net free reserves 2/ ($ millions)	-323	-165	21	-551
Member bank borrowings 2/ ($ millions)	475	492	823	374
Capital Market (N.S.A.)				
Market yields (per cent)				
5-year U.S. Treas. bonds 1/	5.45	5.47	6.15	5.45
20-year U.S. Treas. bonds 1/	5.27	5.28	5.68	5.18
Corporate new bond issues, Aaa adjusted 8/	6.26	6.30	6.83	6.13
Corporate seasoned bonds, Aaa 1/	6.00	5.97	6.29	5.95
Municipal seasoned bonds, Aaa 1/	4.20	4.23	4.35	3.80
FHA home mortgages, 30-year 3/	--	7.35	7.52	6.83
Common stocks, S&P composite series 4/				
Prices, closing (1941-43=10)	102.67	101.51	102.67	92.48
Dividend yield (per cent)	2.97	3.01	3.20	2.94

	Latest month	Amount	3-month average	Change from year earlier: Latest month	Change from year earlier: 3-month average
New Security Issues (N.S.A., $ millions)					
Corporate offerings 5/	Oct. '68 e/	1,100	1,030	-744	-644
State & local govt. public offerings	Oct. '68 e/	1,600	1,509	625	451
Comm. & fin. co. paper (net change in outstandings)	Aug. '68	+ 988	+ 772	+1,216	+856

	Latest month	Out-standings Latest month	Change Latest month	Change 3-month average	Annual rate of change from Pre-ceding month	Annual rate of change from 3 months ago	Annual rate of change from 12 months ago
Banking (S.A.)		($ billions)			(per cent)		
Total reserves 1/	August '68	26.43	0.51	0.24	23.5	11.2	7.3
Credit proxy 1/	"	285.9	5.0	2.9	21.4	12.4	7.4
Bank credit, total 6/	"	369.1	4.5	4.2	14.8	14.3	9.7
Business loans	"	92.0	0.8	0.8	10.5	10.7	9.7
Other loans	"	148.3	1.8	1.9	14.7	16.3	10.6
U.S. Govt. sec.	"	63.4	0.8	0.9	15.3	17.8	3.4
Other securities	"	65.4	1.2	0.6	22.4	12.0	14.1
Total liquid assets 1/ 6/	"	682.8	4.0	4.3	7.1	7.6	7.5
Demand dep. & currency 1/	"	190.2	0.8	1.4	5.1	8.8	6.3
Time & sav. dep., comm. banks 1/	"	193.8	3.4	2.1	21.4	13.2	9.4
Savings, other thrift instit. 6/	"	191.8	1.6	1.1	10.1	6.8	6.7
Other 6/ 7/	"	107.0	-1.8	-0.2	-19.9	-2.6	8.0

N.S.A. -- not seasonally adjusted S.A. -- seasonally adjusted p - Preliminary. e. Estimated by F.R.B. 1/ Average of daily figures. 2/ Average for statement week ending September 25 3/ Latest figure is monthly average for August. 4/ End of week closing prices; yields are for Friday. 5/ Corporate security offerings include both bonds and stocks. 6/ Month-end data. 7. U.S. savings bonds and U.S. Government securities maturing within 1 year. 8/ Adjusted to Aaa basis.

U.S. BALANCE OF PAYMENTS
(In millions of dollars)

	1967 I	1967 II	1967 III	1967 IV	1968 I	1968 II	1968 July[p]	1968 Aug.[p]
				Seasonally adjusted				
Goods and services, net 1/	1,293	1,269	1,359	848	356[r]	492		
Trade balance 2/	975	1,098	1,085	319	87[r]	9[r]	99	24
Exports 2/	7,661	7,703	7,626	7,478	7,924	8,302[r]	2,783[r]	2,871
Imports 2/	-6,686	-6,605	-6,541	-7,159	-7,837[r]	-8,293[r]	-2,684	-2,847
Services balance	318	171	274	529	269	483		
Remittances and pensions	-262	-392	-358	-263	-266	-280		
Govt. grants & capital 3/	-1,176	-1,039	-988	-1,008	-1,164[r]	-1,101		
U.S. private capital	-975	-1,104	-1,788	-1,638	-646[r]	-1,230		
Direct investments	-653	-651	-902	-815	-374[r]	-1,034		
Foreign securities	-259	-199	-476	-332	-385[r]	-81		
Banking claims	79	-198	-435	95	364[r]	204		
Other	-142	-56	25	-586	-251[r]	-319		
Foreign capital, nonliquid	865	1,202	766	353	1,365[r]	2,171		
Official foreign accts.	382	724	18	150	331[r]	923		
Long-term deposits	304	584	-215	147	119[r]	160		
U.S. Govt. liab.	78	140	233	3	212[r]	763		
Int'l. institutions 4/	70	97	117	30	-92[r]	-19		
Other 5/	413	381	631	173	1,126[r]	1,267		
Errors and omissions	-250	-458	207	-34	-305[r]	-222		
			Balances, with and without seasonal adjustment (- deficit)					
Liquidity balance, S.A.	-505	-522	-802	-1,742	-660[r]	-170[r]		
Seasonal component	267	302	-410	-159	411[r]	303[r]		
Balance, N.S.A.	-238	-220	-1,212	-1,901	-249[r]	133[r]	-208	-403
Official settlements balance, S.A.	-1,764	-806	247	-1,082	-535[r]	1,459[r]		
Seasonal component	485	101	-272	-314	629[r]	102[r]		
Balance, N.S.A. 6/	-1,279	-705	-25	-1,396	94[r]	1,561[r]	-73	-17
			Reserve changes, N.S.A. (decrease -)					
Total monetary reserves	-1,027	419	375	181	-904	137	-285	303
Gold stock	-51	-15	-92	-1,012	-1,362	-22	213	-5
Convertible currencies	-1,007	424	462	1,145	401	-267	-907	294
IMF gold tranche	31	10	5	48	57	426	409	14

1/ Equals "net exports" in the GNP.
2/ Balance of payments basis which differs a little from Census basis.
3/ Net of scheduled and non-scheduled repayments.
4/ Long-term deposits and Agency securities.
5/ Includes some foreign official transactions in securities.
6/ Differs from liquidity balance by counting as receipts (+) increase in liquid liabilities to commercial banks, private nonbanks, and international institutions (except IMF) and by not counting as receipts (+) increases in certain nonliquid liabilities to foreign official institutions.

THE ECONOMIC PICTURE IN DETAIL

The Nonfinancial Scene

The gross national product. Growth in the economy slowed in the quarter just ended--although by much less than was earlier anticipated--and is expected to continue to grow at about that reduced rate in the fourth quarter. Increases in current dollar GNP in excess of $20 billion in the first two quarters of the year are expected to be followed by a rise of about $14 billion in each of the last two quarters. Real growth should show a comparable decline, from over 6 per cent in the first half to less than half this rate in the final two quarters. In the fourth quarter, private final sales are expected to contribute significantly less to GNP growth and inventory expansion to contribute more. The GNP deflator is expected to ease to a 3.6 per cent annual rate of increase in the fourth quarter from 4 per cent in the second.

A strong pickup in consumption expenditures was a major factor sustaining growth in the third quarter. Although the increase in personal income was unexpectedly large, the surtax limited growth in disposable income to about $7 billion--only about 60 per cent of the rise in the preceding quarter. But this drop was more than offset in its effect on consumer expenditures by a sharp reduction in the saving rate, from 7.5 to 6.5 per cent. Sales of new domestic cars were especially strong, rising to an advanced rate of 8.8 million annually--the highest since early 1966--probably reflecting some advance buying to avoid price increases in the new models. Nondurable goods sales also rose sharply, in part due to sharp further advances in prices of apparel, footwear, and gasoline. However, it is worth noting that after the strong surge in July retail sales there appeared to be only a small further rise in August and a slight decline in September. (A general revision of the retail sales series, based on an improved sample, may result in the rise in July being reduced to about 2 per cent over June instead of the 3 per cent indicated in the old sample; growth in August is indicated to be a little more than shown by the current series.

Housing activity in the third quarter showed little rise, but this contrasts sharply with the decline expected earlier. Starts rose abruptly in July partly because of some special influences, but remained at a rate in excess of 1.5 million units in August; the rate now seems likely to average close to 1.5 million units for the third quarter as a whole. Lifting of regulatory ceilings on mortgage rates in some states probably contributed, along with lender anticipations of larger savings inflows and lower mortgage rates ahead. Underlying demand for housing is exceptionally strong.

A major factor in the slower growth in GNP in the third quarter was the substantially smaller rate of inventory accumulation than in the second quarter when steel and auto stocks were being accumulated, at a rapid rate. Leveling-off in prime contracts for Vietnam, as well as in unfilled orders for durable goods, suggests that the protracted build-up of long lead-time items is tapering off, and inventory changes from now on may be more closely linked to changes in current and expected consumption--aside, of course, from the continuing readjustment in steel inventories.

The speed of further growth in the GNP in the fourth quarter depends to a large degree on the relative strength of consumer demand and inventory accumulation. Following its rapid run-up in the third quarter when the saving rate declined abruptly, consumption is expected to grow more slowly in the current period and the saving rate to hold at around its current reduced level. Personal income is expected to expand less rapidly, limiting growth in disposable income to a rate comparable to that in the third quarter when the main impact of the surcharge was felt. Consumer purchases of autos may drop somewhat if, as seems likely, there was bunching of demand in the third quarter. We also have projected an increase in non-durable goods sales slightly smaller than in the past quarter--a still substantial rise despite the fact that there apparently has been no growth in this category since July.

On the other hand, our estimates of inventory growth have been revised up substantially since last month because of the strength in demand shown in recent months and continued high levels of industrial output. Inventory accumulation is now projected to rise more rapidly in the fourth quarter, despite the fact that steel inventories, which began to be used up in the third quarter, should be drawn down faster in the October-December quarter. If auto sales do decline as our projections indicate, there should be a further rise in dealer's auto stocks, as producers are likely to continue to schedule new models output at high rates. Nondurable goods stocks are low relative to sales, and are likely to be increased somewhat. In addition, if business is anticipating a stronger rise in final sales in the fourth quarter,than is realized, as seems likely, some unintended stock accumulation will occur.

Other sectors are expected to contribute little to growth for the remainder of this year. Federal purchases of goods and services, fixed investment, and residential construction combined are now adding less to economic expansion than at any time since the Vietnam buildup. These "autonomous" sectors added $10 billion to GNP growth between the fourth quarter of 1967 and the second quarter of this year, but are likely to add only half that between the second and the fourth quarter. From the third to fourth quarter, in particular, little rise in these components is expected. Investment in plant and equipment is likely to show no further gain, as suggested by the revisions in spending anticipations reported both for the manufacturing and the commercial categories. Housing expenditures may edge up somewhat in the fourth quarter, largely because of the relatively advanced rate of starts in the preceding quarter. The third quarter rate of starts will probably be maintained in the coming quarter, but a sharp rebound seems unlikely before next year.

At present, there is no reason to modify greatly our previous estimates of little growth in Federal goods and service outlays in the current quarter. In order not to exceed NIA purchases as indicated by the Budget Review, a downward trend for the rest of fiscal year is implied. Thus, defense expenditures are expected to drop a little in the fourth quarter, as the economy program bites harder. In addition, grants to States are beginning to be curtailed, and sizable cuts have already been made in Federal payrolls, in highway aid and other developmental projects, NASA, and other programs. An increase above Budget estimates of over one billion dollars in CCC and welfare payments (if not exempted) may be offset by further cuts requested of Agriculture and HEW, according to the mid-year Budget Review.

With receipts rising, and expenditures being curtailed, the Federal deficit, NIA basis, is now expected to drop from over $10 billion annual rate in the second quarter to about $3 in the fourth. This drop, larger than previously anticipated, reflects a faster rise in receipts due to unexpected strength in activity and incomes.

GROSS NATIONAL PRODUCT AND RELATED ITEMS
(Quarterly figures are seasonally adjusted. Expenditures and income figures are billions of dollars, with quarterly figures at annual rates)

	1967	1968	1967		1968		Projected	
			III	IV	I	IIr	III	IV
Gross National Product	789.7	858.2	795.3	811.0	831.2	852.9	867.5	881.0
Final sales	783.6	851.7	789.9	802.7	829.1	842.1	862.0	873.5
Private	605.2	654.6	610.3	619.2	638.6	646.4	662.1	671.2
Personal consumption expenditures	492.2	533.9	495.5	502.2	519.4	527.9	540.5	547.8
Durable goods	72.6	81.7	73.1	74.2	79.0	81.0	84.0	82.8
Nondurable goods	215.8	231.5	216.4	218.4	226.5	228.2	233.5	237.7
Services	203.8	220.7	205.9	209.6	213.9	218.7	223.0	227.3
Gross private domestic investment	114.3	124.7	114.7	121.8	119.7	127.3	124.5	127.2
Residential construction	24.6	29.6	26.0	28.5	29.1	29.5	29.6	30.2
Business fixed investment	83.6	88.6	83.3	85.0	88.6	87.0	89.4	89.5
Change in business inventories	6.1	6.5	5.3	8.3	2.1	10.8	5.5	7.5
Nonfarm	5.6	6.0	4.8	7.1	1.6	10.4	5.0	7.0
Net Exports	4.8	2.5	5.4	3.4	1.5	2.0	2.6	3.7
Gov't. purchases of goods & services	178.4	197.1	179.6	183.5	190.5	195.7	199.9	202.3
Federal	90.6	100.2	91.3	93.5	97.1	100.0	101.8	102.0
Defense	72.4	79.1	72.9	74.6	76.8	79.0	80.5	80.2
Other	18.2	21.1	18.4	19.0	20.3	21.0	21.3	21.8
State & local	87.8	96.9	88.4	90.0	93.4	95.6	98.1	100.3
Gross national product in constant (1958) dollars	673.1	704.2	675.6	681.8	692.7	703.4	708.0	712.5
GNP implicit deflator (1958=100)	117.3	121.8	117.7	118.9	120.0	121.2	122.5	123.6
Personal income	628.8	684.8	633.7	645.2	662.7	678.1	693.4	705.0
Wages and salaries	423.4	462.8	426.3	436.4	448.3	457.6	468.2	477.0
Disposable income	546.3	589.2	550.0	559.6	574.4	586.3	593.6	602.4
Personal saving	40.2	40.8	40.5	43.4	40.8	44.0	38.5	39.9
Saving rate (per cent)	7.4	6.9	7.4	7.8	7.1	7.5	6.5	6.6
Corporate profits before tax	81.6	90.2	80.8	85.4	88.9	91.8	90.3	89.8
Federal government receipts and expenditures (N.I.A. basis)								
Receipts	151.2	175.4	152.2	156.4	166.6	171.8	179.7	183.5
Expenditures	163.6	182.3	165.1	168.6	175.1	181.9	185.8	186.4
Surplus or deficit (-)	-12.4	-7.0	-12.9	-12.2	-8.6	-10.2	-6.2	-2.9
Total labor force (millions)	80.8	82.4	81.1	81.6	81.9	82.2	82.4	82.9
Armed forces "	3.4	3.6	3.5	3.5	3.5	3.5	3.6	3.6
Civilian labor force "	77.3	78.8	77.6	78.2	78.4	78.7	78.8	79.3
Unemployment rate (per cent)	3.8	3.7	3.9	3.9	3.6	3.6	3.6	3.9
Nonfarm payroll employment (millions)	66.0	68.0	66.1	66.7	67.4	67.8	68.3	68.5
Manufacturing	19.4	19.7	19.3	19.5	19.6	19.7	19.8	19.7
Industrial production (1957-59=100)	158.0	163.8	157.2	159.5	162.1	164.0	164.5	164.5
Capacity utilization, manufacturing (per cent)	85.3	84.0	84.3	84.7	84.9	84.7	83.6	82.6
Housing starts, private (millions A.R.)	1.27	1.47	1.38	1.43	1.47	1.44	1.49	1.49
Sales new domestic autos (millions, A.R.)	7.57	8.49	7.57	7.44	8.19	8.44	8.83	8.50

CHANGES IN GROSS NATIONAL PRODUCT
AND RELATED ITEMS

	1967	1968	1967 III	1967 IV	1968 I	1968 IIr	1968 Projected III	1968 Projected IV
	------------In billions of dollars------------							
Gross National Product	42.1	68.5	15.1	15.7	20.2	21.7	14.6	13.5
Final sales	50.8	68.1	11.9	12.8	26.4	13.0	19.9	11.5
Private	28.6	49.4	9.6	8.9	19.4	7.8	15.7	9.1
GNP in constant (1958) dollars	16.0	31.1	6.4	6.2	10.9	10.7	4.6	4.5
Final sales	24.0	31.1	3.5	3.4	16.9	2.8	9.4	2.9
Private	9.8	22.7	3.1	2.8	12.4	0.1	8.7	2.1
	-------------In Per Cent Per Year-------------							
Gross National Product	5.6	8.7	7.7	7.9	10.0	10.4	6.8	6.2
Final sales	6.9	8.7	6.1	6.5	13.2	6.3	9.5	5.3
Private	5.0	8.2	6.4	5.8	12.5	4.9	9.7	5.5
Personal consumption expenditures	5.7	8.5	4.2	5.4	13.7	6.5	9.5	5.4
Durable goods	3.0	12.5	-1.6	6.0	25.9	10.1	14.8	-5.7
Nondurable goods	4.4	7.3	2.0	3.7	14.8	3.0	9.3	7.2
Services	8.2	8.3	8.5	7.2	8.2	9.0	7.9	7.7
Gross private domestic investment	-5.4	9.1	26.4	24.8	-6.9	25.4	-8.8	8.7
Residential construction	-0.8	20.3	58.1	38.5	8.4	5.5	1.4	8.1
Business fixed investment	2.8	6.0	2.9	8.2	16.9	-7.2	11.0	0.4
Gov't purchases of goods & services	14.2	10.5	5.2	8.7	15.3	10.9	8.6	4.8
Federal	17.1	10.6	5.8	9.6	15.4	11.9	7.2	0.8
Defense	19.5	9.3	4.4	9.3	11.8	11.5	7.6	-1.5
Other	8.3	15.9	11.2	13.0	27.4	13.8	5.7	9.4
State & local	11.4	10.4	5.5	7.2	15.1	9.4	10.5	9.0
GNP in constant (1958) dollars	2.4	4.6	3.8	3.7	6.4	6.2	2.6	2.5
Final sales	3.7	4.7	2.1	2.0	10.0	1.6	5.4	1.7
Private	1.9	4.3	2.4	2.1	9.3	0.1	6.4	1.5
GNP implicit deflator	3.1	3.8	3.8	4.1	3.7	4.0	4.3	3.6
Personal income	7.2	8.9	7.8	7.3	10.8	9.3	9.0	6.7
Wages and salaries	7.3	9.3	8.3	9.5	10.9	8.3	9.3	7.5
Disposable income	6.8	7.9	6.3	7.0	10.6	8.3	5.0	5.9
Corporate profits before tax	-4.7	10.5	2.5	22.8	16.4	13.0	-6.5	-2.2
Federal government receipts and expenditures (N.I.A. basis)								
Receipts	5.7	16.0	10.8	11.0	26.1	12.5	18.4	8.5
Expenditures	14.9	11.4	8.9	8.5	15.4	15.5	8.6	1.3
Nonfarm payroll employment	3.1	3.0	2.4	3.6	4.2	2.4	2.9	1.2
Manufacturing	1.0	1.5	-2.1	4.1	2.0	2.0	2.0	-2.0
Industrial production	1.1	3.7	3.3	5.9	6.5	4.7	1.2	0.0
Housing starts, private	11.4	15.7	63.9	14.5	11.2	-8.2	13.9	0.0
Sales new domestic autos	-9.7	12.2	-26.6	-6.9	40.3	12.2	18.5	-14.9

<u>Industrial production.</u> From June to August changes in the total index of industrial production have been dominated by changes in output of materials, as production of both consumer goods and business equipment have been virtually unchanged. If these trends continued in September, the total index is tentatively estimated to have declined further, by about one-half to one point, from the preliminary August level of 164.0 per cent.

In September, output of raw steel declined 10 per cent further as steel consuming industries continued to reduce their metal inventories. Output of crude oil was reduced 2.5 per cent because of a cutback in Texas allowables and auto assemblies declined 3.5 per cent because of start-up problems on production lines. Other available September output data--on paperboard, trucks, coal, and petroleum refining--do not suggest any softening in production; and output of these products remained at advanced levels.

Output changes for the balance of the year will most likely depend on demands for consumer goods and business equipment. While retail sales, based on a rough deflated measure, have increased about 5 per cent over the past 12 months, output of these goods has shown a similar rise. It is not yet clear, however, that the current advanced level of sales is enough to be a spur to further expansion of output of these products. More complete output data for August and preliminary September data, which will become available over the next 2 weeks, may provide a clue.

Output of business equipment has been on a plateau since last October at a level about 3 per cent below the December 1966 high. With the rate of capacity utilization in manufacturing below 83 per cent, despite a 3-1/2 to 4 per cent increase in total manufacturing output over the past 12 months, there does not appear to be any great pressure to expand productive capacity generally in manufacturing.

Capacity utilization. The September rate of capacity utilization is expected to be down a little further from the 83.2 per cent level recorded in August. At its present level the operating rate also is slightly below its previous low point which occured in September and October of last year. Capacity still appears to be expanding rapidly although not so fast as in the previous two years.

Operating rates appear moderately high in the motor vehicle rubber, petroleum, and aircraft industries. Considerable unused capacity exists for the production of most iron and steel, stone, clay and glass, and machinery products.

UTILIZATION RATES
(Per cent)

Industry	1967		1968				
	QIII	Q IV	Q I	Q II	July	August	Sept. (e)
Manufacturing	84.3	84.7	84.9	84.7	84.7	83.2	82.6
Primary processing Industries	83.0	85.3	85.5	86.3	86.3	83.2	--
Advanced processing Industries	85.2	84.3	84.4	83.6	83.6	83.3	--

Retail Sales. Retail sales in the three weeks ending September 21 suggest a level for the month slightly below July and August. Because of the sharp increase in July, however, sales for the quarter as a whole were substantially above the second quarter.

The Bureau of the Census will shortly introduce a new sample which is expected to result in some revisions for the period since July 1967. The new sample apparently indicates a smaller rise from June to July than that now published and a somewhat larger rise from July to August.

Unit auto sales and stocks. Sales of new domestic autos in the first 20 days of September were maintained at or slightly above the August seasonally adjusted annual rate of 8.6 million units. Stocks of new domestic autos increased more than seasonally in the second ten-day period of September and on the 20th were 13 per cent above the end of August level and 19 per cent above a year earlier. Some trade sources, however, regarded current stocks as relatively low in view of the strong prospective sales picture.

Consumer credit. Consumers continued to expand their instalment debt in August at a rapid rate. Credit extended during the month rose, while repayments slackened somewhat.

The increase in debt was concentrated in automobile credit, especially purchased paper. Although auto sales in August were somewhat below those in July, sales continued large and consumers made more intensive use of bank credit in purchasing cars. The expansion in auto credit use was nationwide. Credit appears to have been used extensively by buyers brought into the August market to avoid higher prices on 1969 models, and to take advantage of any prive concessions available on 1968 models. Nonautomotive consumer goods credit and personal loans were only moderately larger than in July.

August repayments on auto credit outstanding fell below the record monthly high of $2.4 billion, seasonally adjusted, reached in July but were still near the level of other recent months. Repayments on other types of instalment credit were well maintained.

Repayments currently are taking a somewhat smaller proportion of disposable income than a year earlier. As shown in the table, estimates for the third quarter indicate that repayments absorbed only 14 per cent of disposable income, down from the sustained high of 14.3 per cent in much of 1965 and early 1966, and .4 of a point below the one-time peak a year ago.

RATIO OF CONSUMER INSTALMENT DEBT REPAYMENTS
TO DISPOSABLE INCOME
(seasonally adjusted annual rates)

Period	Repayments (billions of $)	Per cent
1965-Q1	65.1	14.3
Q2	66.4	14.3
Q3	68.5	14.3
Q4	70.0	14.2
1966-Q1	71.7	14.3
Q2	72.3	14.3
Q3	73.4	14 2
Q4	73.9	14.1
1967-Q1	75.0	14.0
Q2	77.1	14.2
Q3	79.3	14.4
Q4	79.6	14.2
1968-Q1	80.7	14.1
Q2	82.2	14.0
Q3 (est.)	83.2	14.0

Manufacturers' orders and shipments.[1/] New orders received by durable goods manufacturers rose by nearly 1 per cent in August but, as in June and July, they remained below the level in the 6-month period from last December through May. Declines in new orders for iron and steel, nonferrous metals, and nonelectrical and electrical machinery were more than offset in August by increases for transportation equipment--mainly outside the auto industry.

Unfilled orders of durable goods manufacturers rose fractionally in August, largely because of a sharp decline in shipments. This was

1/ The series on manufacturers' shipments, orders, and inventories has been revised, including adjustment to levels established by the 1963 Census and Annual Surveys and up-dating of seasonals. Total manufacturers' shipments and new orders in 1967 were 2 per cent above previously reported levels; the upward revisions were mainly in durables, partly offset by downward revisions in nondurables. Durables shipments and orders were 7-8 per cent above the unrevised levels. The greatest year-to-year revision in the durables series was 1965, when shipments and new orders show 3-1/2 per cent more increase over 1964 levels than previously estimated. The recent monthly pattern of changes in orders has not been materially chnnged by the revision.

the first increase in backlogs in four months and was concentrated in the transportation equipment industries.

Manufacturers' shipments dropped sharply in August--more than 3 per cent--with the bulk of the decline in durable goods industries, where a drop of over 40 per cent for iron and steel producers accounted for half the fall-off. Shipments by the aerospace industry also declined sharply. Of other durable goods industries only nonelectrical machinery and motor vehicles and parts reported higher shipments.

<u>Manufacturers' inventories.</u> Book value of manufacturers' inventories rose $1 billion in August, about four times the rise in July. Except for a $900 million rise in May, the newly revised inventory figures indicate that monthly increases since early last year had seldom exceeded $400 million.

Two-thirds of the August increase was at durable goods producers, with increases occurring in all major industries except electrical machinery and instruments and related products. The largest advances in August were at producers of iron and steel, motor vehicles,and parts, and aircraft, missiles and parts. In the durable goods sector materials and supplies, work in process, and finished goods all showed increases. Inventories held by nondurable goods producers increased somewhat more than the average increase of the last eighteen months, with increases fairly widespread.

Construction and real estate. Seasonally adjusted private housing starts, which had risen sharply in July from a reduced May-June rate, continued above a 1.5 million unit annual rate in August. Single family starts dropped as expected, after a fillip in July, to one of the lowest rates this year and were also below a year earlier. However, multifamily starts advanced further and approached the recent peak of last April.

Regionally, housing starts in the Northeast, which had played a major part in the rise during July when higher usury ceilings went into effect in New York and New Jersey, dropped sharply in August. And starts in the North Central states also declined. But in the West--the only region which had not shared in the July advance--starts soared to one of the highest rates for the year. Starts also rose slightly in the South.

Seasonally adjusted residential building permits--revised moderately upward in July--declined in August. Although multifamily structures accounted for all the August drop, single and multifamily permit rates were both relatively low. Altogether, they averaged more than a tenth below the recent peak reached last March.

Apart from the downtrend in building permits, housing starts in excess of a 1.5 million unit rate over the near-term would hardly seem sustainable in view of the limited flow of loanable funds to major lending institutions. Even if starts declined appreciably in September, however, the average for the third quarter should exceed the 1.44 million unit second quarter rate.

PRIVATE HOUSING STARTS AND PERMITS

	August 1968 (thousands of units) 1/	Per cent change from	
		July 1968	August 1967
Starts	1,508	- 2	+ 8
1 - family	860	- 5	- 2
2 - or-more family	648	+ 3	+ 22
Northeast	250	- 21	+ 42
North Central	345	- 6	- 8
South	619	+ 3	+ 8
West	294	+ 21	+ 4
Permits	1,246	- 3	+ 7
1- family	663	--	- 1
2 - or-more family	583	- 7	+ 18

1/ Seasonally adjusted annual rates; preliminary.

Sales of existing homes in July averaged a fifth above a year earlier, according to the National Association of Real Estate Boards, reflecting in part recent upward adjustments in State usury rate ceilings. Sales of new single family homes by speculative builders rose during July to a seasonally adjusted annual rate of 500,000 units, the highest since April, but the stock of homes for sale by such builders remained quite limited.

Personal income. Continuing its rapid rate of growth, personal income rose $5 billion in August to reach a seasonally adjusted annual rate of $694 billion. Wage and salary disbursements accounted for $3-1/3 billion of the total rise. Although there was some easing of demand for industrial labor this summer, rising wage rates pushed gross payrolls in commodity-producing industries up at a 4.8 per cent annual rate from May to August. Major support for the rise in personal income, however, came from the nonindustrial sector, where rising employment and increasing wages combined to expand payrolls substantially. Sizable increases in government payrolls reflected partly the Federal pay increase in July and partly a substantial rise in the State and local sector where employment increased sharply.

INCREASES IN NONFARM WAGE AND SALARY PAYMENTS
MAY TO AUGUST 1968

	Per cent increase, at annual rates, in:		
	Total Wage and salary payments	Payroll employment	Payments per employee
Total	9.3	3.6	5.7
Commodity-producing industries1/	4.8	0.5	4.3
Manufacturing	6.7	1.7	5.0
Distributive industries2/	13.0	4.5	8.5
Services industries	11.8	4.7	6.9
Government 3/	12.0	7.3	4.6

1/ Includes mining, construction and manufacturing.

2/ Includes wholesale and retail trade and transportation and public utilities.

3/ Excludes military payrolls.

Illustrative of the continuing sharp rise in pay levels, wage and salary payments per employee rose at an annual rate close to 6 per cent over the May-August period. In the nonindustrial groups, where demands continued strong, the increases ranged from 4.6 to 8.5 per cent at annual rates. In the commodity-producing group, such payments advanced at a comparatively moderate 4.3 per cent annual rate; the average increase in these industries was held down by reductions in average hours--mostly in overtime--and by employment cutbacks in high-wage construction and primary metals industries.

Transfer payments, which rose by $1.3 billion from May to a record $59.5 billion (annual rate) in August, also contributed significantly to the rise in personal income. There were also large increases in personal interest income, which rose nearly $2 billion from May to an annual rate of over $53 billion in August, and in dividends, which rose to $25 billion in August.

Labor market. The labor market has continued to show considerable firmness. Employment rose in the nonindustrial sector in August while an unusual dip in the civilian labor force reduced the unemployment rate to 3.5 per cent--equal to its post-Korean low, reached last January and again in April and May. Firmness apparently continued into late September, with insured unemployment near record lows and no signs of significant layoffs outside of the steel industry.

Despite this picture of strength there have been several hints of easing. Industrial employment has shown no change for several months, the manufacturing workweek--a generally reliable lead indicator--has moved down somewhat, and labor force growth has been below normal for the past half year. Leveling in industrial demand for labor in August was overshadowed by an increase of about 210,000 in nonindustrial employment. Service employment, which rose only slightly from February to May, has risen considerably since May.

Demands also have intensified in State and local government where employment rose substantially from May to August.

On the supply side, the civilian labor force as a whole declined by some 300,000 in August (seasonally adjusted). As a result, the labor force was no higher than six months earlier, and was only 1.1 million above a year ago--an increase of about 1.4 million is considered normal. A similar pattern of no labor force growth developed for several months during the economic slowdown early last year and served to keep the unemployment rate down for a period. The decline in the unemployment rate in August appeared to be closely associated with contraction of the labor force, which was related in part to the impending end of school vacations. The August decline in unemployment was sharpest among teenagers, whose unemployment rate fell one and a half points to 12.0 per cent. The employment status of the major component of the labor force--adult males--remained unchanged, and the unemployment rate for adult women edged lower.

Wages and industrial relations. Upward pressure on wages is expected to ease somewhat as the tempo of collective bargaining activity slackens in the final quarter of 1968. Less than half a million workers are covered by contracts which expire or provide for wage reopening, compared with 1.3 million in the third quarter. Deferred wage increases and cost-of-living adjustments in the fourth quarter will affect about 1.2 million workers under major contracts negotiated last year in automobiles and related industries. But these increases will average around 5 per cent compared with average first-year increases of 7 per cent or more negotiated in settlements reached so far this year.

Contract expirations in manufacturing are concentrated in the aerospace industry, where several recent settlements have probably set the pattern for an increase estimated at 6-1/2 per cent or more in wage and fringe costs.

Outside manufacturing, settlements have not been reached in two key negotiations--coal and shipping. More than 60,000 dock workers in East and Gulf coast ports went out on strike upon expiration of their contract September 30. Upon advice that the strike would endanger the national health and safety, the President set in motion the procedure for obtaining an injunction under the Taft-Hartley law. The report by a 3-man Board of Inquiry, appointed by the President, that no settlement could be reached resulted in a temporary restraining order prior to issuance of an injunction ordering the union back to work for an 80-day "cooling off" period. The longshoremen are expected to go back to work October 3. Job security to cushion the impact of containerization and a guaranteed work-year of 2,080 hours are the main unresolved issues. The Bituminous Coal Operators and 80,000 miners have not yet reached settlement on a new contract. Misunderstanding as to the termination date of the old contract (thought to be September 30 rather than October 9) has led to a walkout of several thousand miners.

Wholesale prices. Following some months of little change, average prices of industrial commodities increased an estimated 0.3 per cent from mid-August to mid-September--the largest rise since late last winter. Steel price increases announced in early August (but not effective until after the August pricing date) accounted for part of the September rise, but in addition there were increases in many other categories. Preliminary September figures suggest a sizable further increase in the diffusion of industrial price increases (final August data show the beginning of a move upward from the low May-to-July level), perhaps back close to the March-April proportions, but still well below the peaks reached last January and February. Since the BLS September pricing date (September 10), a number of additional price increases have been announced, particularly for a variety of industrial chemicals and for 1969 model cars. Thus a further appreciable rise in industrial prices is likely this month.

Accompanying the step-up in industrial prices in September, prices of farm products and processed foods and feeds reversed roughly half of their sizable decline in August. The BLS overall wholesale price rose an estimated 0.4 per cent, returning to the July level of 109.1 per cent of the 1957-59 average. The estimated September WPI was 2.7 per cent above a year earlier, with agricultural products up 3.1 per cent and industrial commodities up 2.5 per cent.

The most conspicuous industrial price advances reported by BLS in September were for steel and lumber and plywood. Lumber and plywood prices continued upward over the summer--although at a less rapid pace than last winter and early spring--and by mid-September were up a fourth from early 1967. With a weight of about 2 per cent, these prices have accounted for 15 per cent of the total increase for industrial commodities since mid-1967.

Prices of steel mill products were virtually stable from May through mid-August. The average increase reported to BLS for their mid-September index fell short of the 2-1/2 per cent indicated by trade reports, suggesting a lag in application of some of the increases announced earlier.

Altogether, the steel and lumber price increases accounted for about 0.1 percentage point--or one-third--of the estimated 0.3 rise in industrial prices in September. In addition to these major increases there was a fairly widespread scattering of small increases in the textile and apparel, hides and leather, paper, metals and metal products, machinery and equipment, and furniture and household durables groups. These increases generally reflected a continuation of August developments, except for the leather, paper, and metals groups which had been unchanged or declined slightly in August.

The continuing advance in lumber-plywood prices, supplemented by gains in textile materials and hides and leather, have more than offset a small further drift-down in nonferrous metals prices (copper prices have tended to stabilize or increase somewhat recently, while lead, gold and silver prices have declined), and the FR index of sensitive industrial materials has moved up appreciably from its low reached in June.

WHOLESALE PRICES OF INDUSTRIAL COMMODITIES
(Special FR groupings based on BLS data; 1957-1959 = 100)

	July 1967	1968 March	June	August	Sept. (est.)
All items	105.2	107.8	107.9	108.1	108.4
Sensitive materials	100.0	108.2	105.9	106.6	107.1
All other industrial commodities	106.0	107.7	108.2	108.3	108.6
Sluggish materials	104.9	106.4	106.8	106.8	na
Cons. nonfood products	105.1	106.8	107.5	107.5	na
Producers' equipment	111.2	114.4	115.1	115.4	na

Consumer prices. The consumer price index rose 0.3 per cent in August, to 121.9 per cent of the 1957-59 average. Since April, the CPI has been running 4 per cent or more above the corresponding year-earlier month; this represents the largest year-over-year rise since the beginning of 1952.

The August increase fell back to about the average rise during the first 5 months of the year, following the temporary spurt to a monthly rate of 0.5 per cent in June and July. The abrupt speed-up in the CPI in June and July can be attributed mainly to a sharp rise in the BLS series representing mortgage interest charges (mortgage interest rates adjusted, among other things, for changes--in recent months, large increases--in new house prices). In each of these two months the rise in mortgage interest accounted for around one-fourth of the total increase in the CPI. As indicated in the table, the CPI excluding mortgage interest increased at an annual rate of 4.7 per cent in June and 4.4 per cent in July, whereas, the total CPI rose at a 6 per cent rate in those months. As also shown in the table, mortgage interest (which has a weight of only 3 per cent) did not influence the CPI over the first 5 months of the year--when the CPI rose at an average annual rate of 4.3 per cent with mortgage interest up by about the same amount.

The rise in mortgage interest continued in August, but at a slower pace (2.3 per cent as compared with a monthly average of over 4 per cent in June and July). This slowing and a pronounced drop in the rate of increase in medical services--to the smallest rise in more than 2 years--largely accounted for the slackening of the increase in the CPI from July to August.

The unprecedented 11 per cent rise in mortgage interest charges, as measured by BLS, between May and August apparently followed in large part from the one-time boost in the statutory rate ceilings on FHA- and VA-guaranteed home loans and from the lifting of legal ceilings in rates in various states. According to the FHA and FHLBB series, mortgage interest rates are now leveling off.

In addition to mortgage interest, food price changes are of special interest in viewing recent changes in the CPI. In June and July a large rise in food prices accounted for about one-fourth of the over-all increase in the CPI, but this rise was less than expected seasonally and the published BLS seasonally adjusted food price index declined somewhat. Thus after allowing for seasonals in food prices--as well as for other commodities--the rise in the CPI in June and July was slower than in the first 5 months of the year.

In August, food prices showed a contra-seasonal rise--tending to boost sharply the rise in the total CPI when calculated using seasonally adjusted indexes for commodity prices. While the August rise more than offset the decline over the preceding 2 months, seasonally adjusted food prices increased at only a one per cent annual rate between May and August--prices of food at home declined moderately over that period--as compared with a rate of 6 percent from December 1967 to May.

There has been no let-up in the rapid advance in retail prices of non-food commodities. Apparel and furniture prices rose sharply further in August, and major appliances continued to move up. Despite a slightly larger-than-seasonal decline in new car prices, prices of commodities less food--after allowances for seasonal influences--increased both in August and, on average, from May to August at an annual rate of over 4 per cent, as compared with 3.7 per cent in the first 5 months of the year.

Recently announced increases for 1969 model cars and also for household durables and clothing, as well as a prospective carry-through of materials' price increases now taking place at wholesale, are likely to keep retail prices of non-food commodities moving upward. It will be important, however, to assess retail price changes this autumn in terms of expected seasonal behavior. BLS current seasonals allow for a 1.3 per cent increase in apparel prices between August and October, the period of introduction of winter clothing; they also allow for a 3.5 per cent increase in new car prices in October--when, by BLS practice, new models are first priced--followed by another 1.1 per cent increase in November.

RECENT CHANGES IN CONSUMER PRICES
(Based on BLS data; per cent changes, at annual rates)

	Not seasonally adjusted		Seasonally adjusted 1/	
	CPI 2/	CPI, excluding mortgage interest	CPI	CPI, excluding mortgage interest
Dec. '67 to May '68 (ave.)	4.3	4.3	4.9	4.9
May to Aug. '68 (ave.)	5.3	4.1	4.7	3.5
June	6.0	4.7	4.7	3.4
July	6.0	4.4	4.1	2.5
August	4.0	3.2	5.3	4.6

1/ Except services.

2/ Regularly published index.

<u>Supplies of livestock products</u>. Retail prices of meats and other livestock products have been advancing since the beginning of the year even though per capita supplies have exceeded record 1967 levels in every month since March. In August, the retail price index was 3.2 per cent above a year earlier and exceeded the October 1966 record by 1 per cent. The usual slackening in prices of these products in the fourth quarter associated with seasonally expanding supplies is likely to be moderate this year because consumer demand continues strong while supplies of some livestock products are indicated to be smaller than a year earlier.

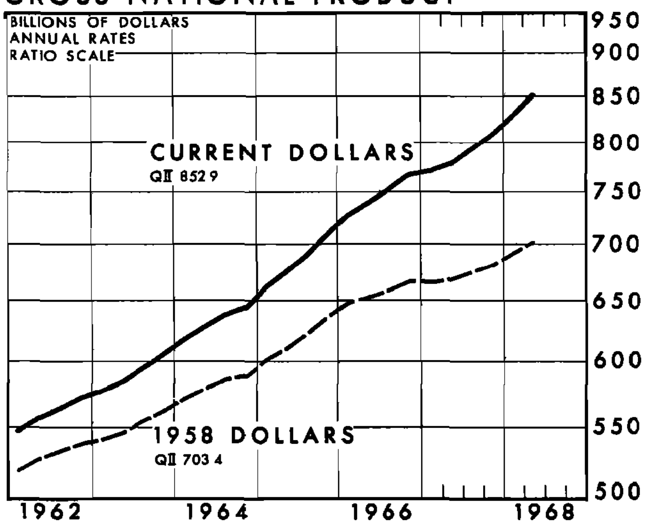
Smaller marketings of eggs, turkeys, and hogs reflect producer decisions earlier in the year to scale down production. The official September survey indicates that pork production, at a seasonal peak in the fourth quarter, will probably fall 1 or 2 per cent short of last year's large output. However, after the turn of the year, production is expected to rise above a year earlier. Short egg supplies are likely to extend through the fourth quarter and beyond because producers have reduced flocks and cannot rebuild them quickly. Turkey supplies in the fourth quarter may be 5 to 10 per cent less than the huge supplies of a year earlier. Milk production will probably be down about 2 per cent as it has been throughout the year.

Production of broiler meat is expanding rapidly and in the fourth quarter is expected to average 4 to 5 per cent above a year earlier. Fed beef production is likely to be considerably above a year earlier unless the survey of cattle on feed available on October 17 contradicts other indicators. Domestic production of non-fed beef is expected to be little changed from a year earlier, but imports from Australia and New Zealand may be curtailed toward the year's end, either through imposition of quotas or through agreement.

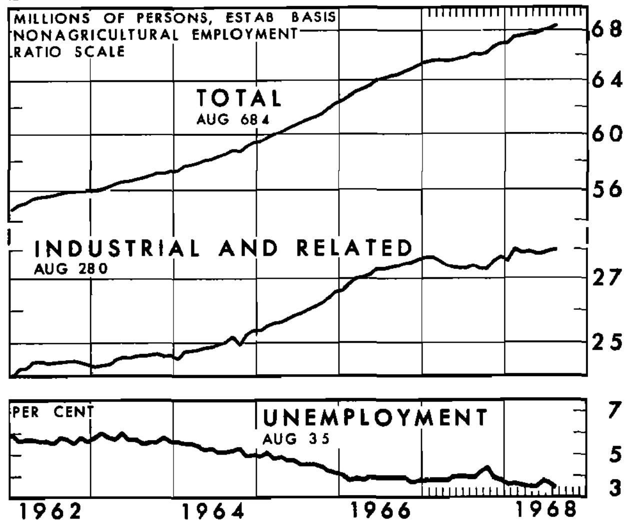
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED

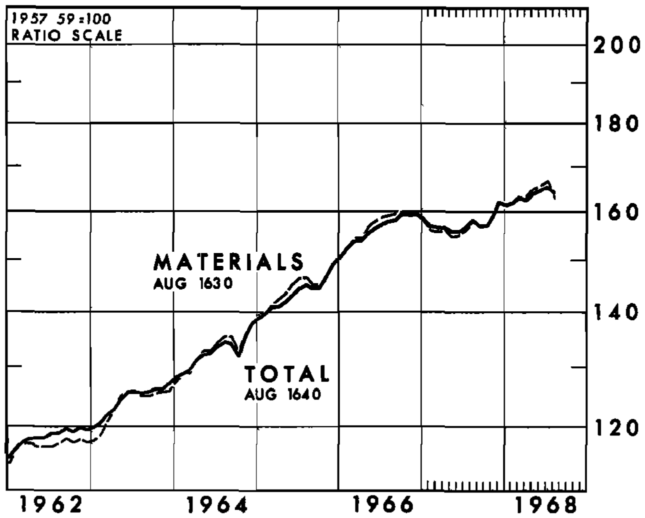
GROSS NATIONAL PRODUCT



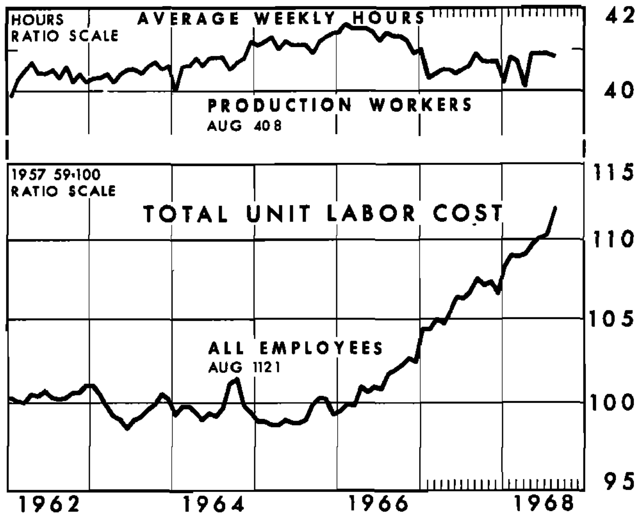
EMPLOYMENT AND UNEMPLOYMENT



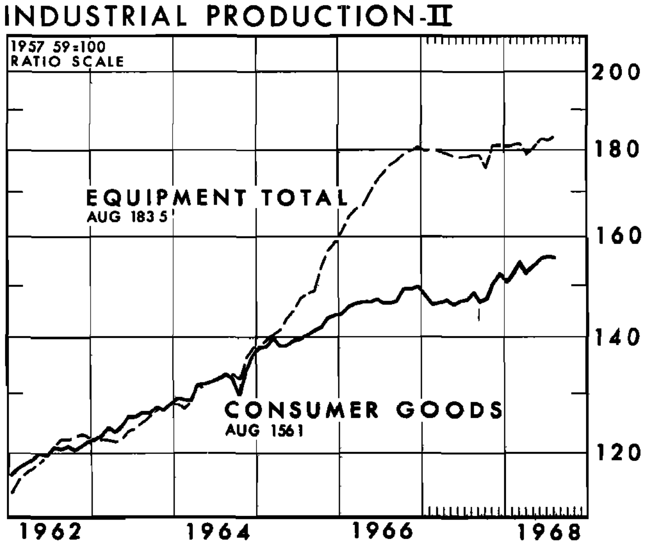
INDUSTRIAL PRODUCTION-I



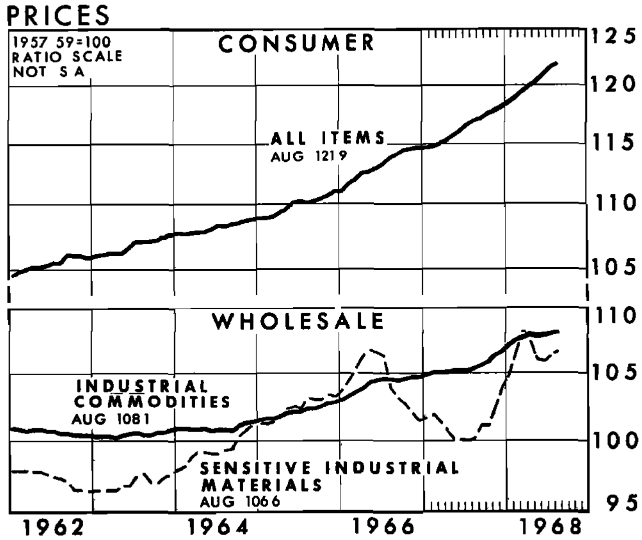
WORKWEEK AND LABOR COST IN MFG.



INDUSTRIAL PRODUCTION-II



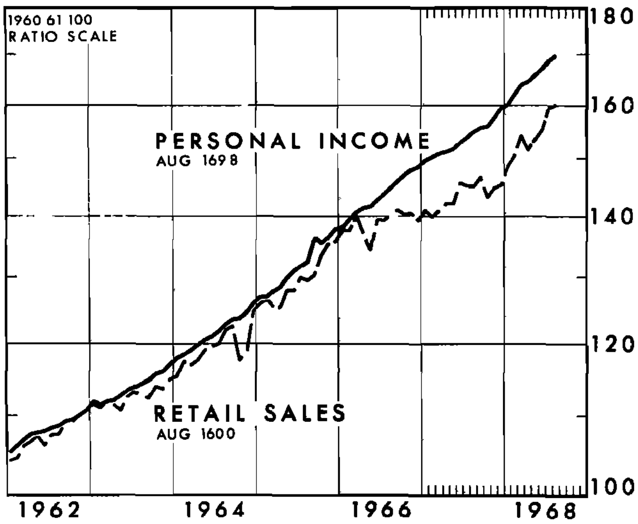
PRICES



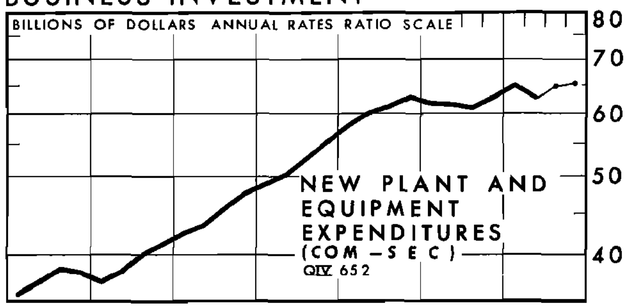
ECONOMIC DEVELOPMENTS - UNITED STATES

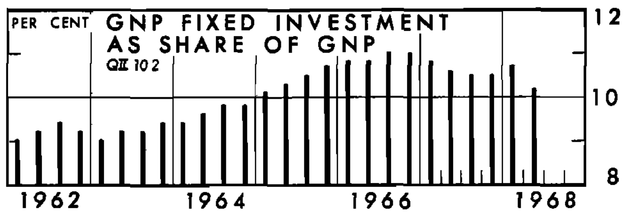
SEASONALLY ADJUSTED

INCOME AND SALES

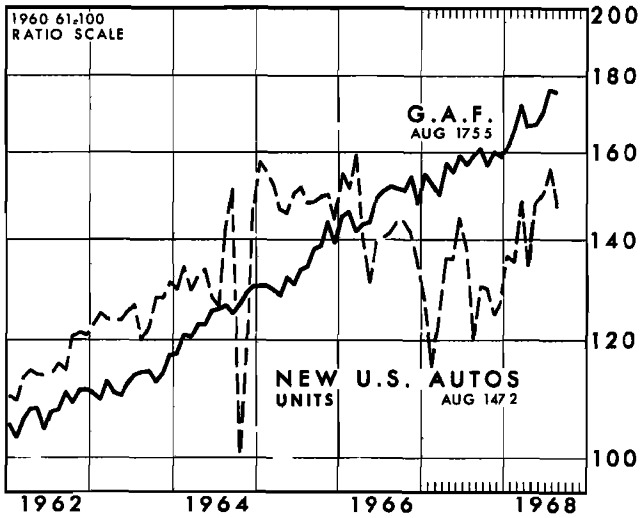


BUSINESS INVESTMENT

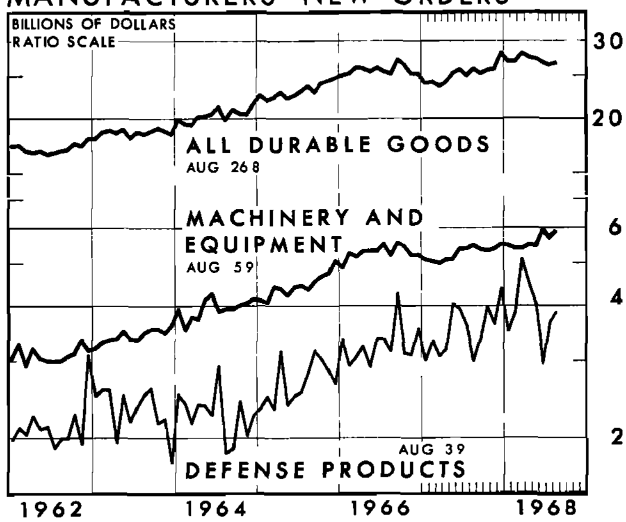




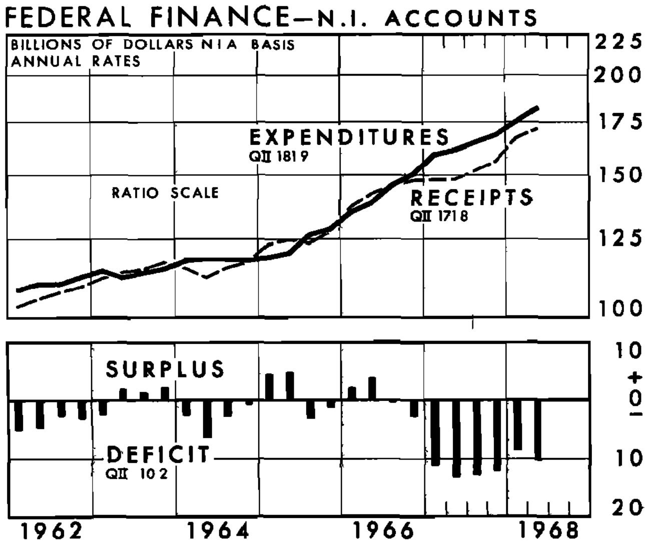
RETAIL SALES



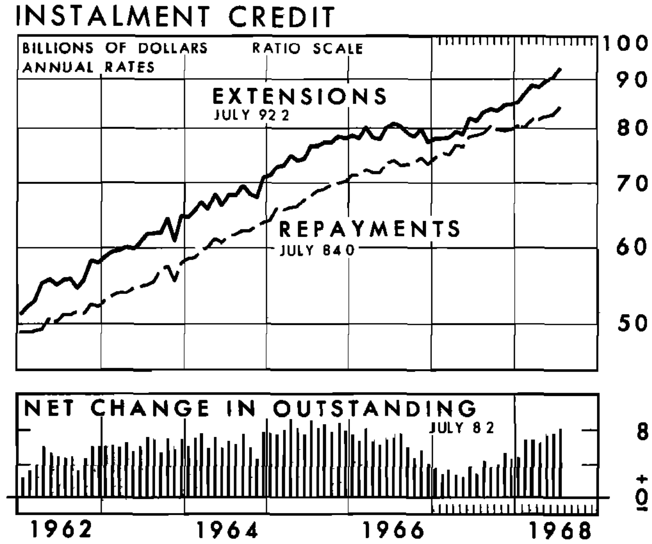
MANUFACTURERS' NEW ORDERS



FEDERAL FINANCE—N.I. ACCOUNTS



INSTALMENT CREDIT



DOMESTIC FINANCIAL SITUATION

Bank credit. Total loans and investments at all commercial banks are estimated to have increased at approximately an 11 per cent annual rate in September, about half the rapid July-August growth rate that resulted principally from heavy bank participation in large Treasury financings as CD funds became readily available. About two-thirds of the September increase reflects further loan expansion, although growth in business loans slackened considerably from the pace of recent months. Banks continued to take large amounts of municipal issues into portfolio--as has been the case since deposit inflows increased around midyear--but made no further net additions to their holdings of U.S. Government securities.

NET CHANGE IN BANK CREDIT
All Commercial Banks
(Seasonally adjusted annual rates, in per cent)

	1967	1968			
		First 9 mos.	First half	Third quarter	Sept.1/
Total loans & investments2/	11.6	10.0	6.2	17.0	11.1
U.S. Gov't. securities	11.4	8.3	2.7	19.2	--
Other securities	26.1	11.1	6.5	19.6	20.2
Total loans	8.3	10.2	7.1	15.8	11.5
Business loans	9.8	9.4	9.5	8.8	5.2
Memo:					
Credit Proxy3/	11.6	8.5	5.5	14.0	9.5

1/ All September rates are preliminary estimates based on incomplete data and are subject to revision.
2/ Last Wednesday of the month series.
3/ Monthly average of daily figures, adjusted to include Euro-dollar borrowing.

The halt of U.S. Government security acquisitions in September reflects the absence of any major Treasury financing, and is in sharp contrast with the rapid increase in bank holdings of these securities over the preceding two months. There was some maturity switching at large banks outside New York, where purchases of bills and short-term notes were approximately offset by sales of longer-term Governments, which probably included some of the 6-year notes acquired in the August financing.

Banks did, however, add $1.1 billion to their holdings of other securities in September--at about a 20 per cent annual rate--bringing net acquisitions since midyear to over $3.0 billion. As in recent months, the September increase was mainly at large banks and was concentrated in municipals--both long and short term. At nonweekly reporting banks, where CD's are relatively unimportant and deposit inflows have not accelerated so much since midyear, acquisitions of municipals and agency issues have continued at about the same pace as earlier in the year.

In spite of the increase in corporate tax liabilities in September, business loans are estimated to have increased by only $400 million, about half of the average monthly increase in the preceding three months. Apparently, corporations were fairly well prepared to meet their higher tax payments, and the ratio of business borrowing over the tax date to total tax payments remained essentially the same as in recent years. Corporate liquidation of commercial paper and CD's during the tax period also was moderate.

Business borrowing at banks both before and after the tax period was relatively light in September. With the exception of some continued strength in textiles, construction, and primary metals (probably to finance expanded plant and equipment programs), most industrial categories displayed about normal or somewhat less than normal expansion in business loans during these weeks. As it became apparent to banks that loan demand was somewhat weaker, scattered reductions in the prime lending rate began to occur early in September, with widespread reductions taking place towards the end of the month. The prime rate is now split, with Chase Manhattan and a few other banks at 6 per cent, while most banks are quoting 6-1/4 per cent.

Security loans increased moderately further in September--bringing the total increase since midyear to about $3.5 billion--as dealers generally maintained a relatively high level of speculative inventories in anticipation that interest rates are still likely to decline further. Growth in consumer loans continued at the increased pace that has prevailed since around midyear, reflecting principally, as in recent months, the financing of a large volume of automobile sales. Real estate loans in September increased at a slightly more rapid rate than in recent months, and may reflect some easing of bank mortgage lending policies in response to improved availability of funds.

Bank deposits. Time and savings deposits at all commercial banks in September are estimated to have increased by an additional $2.7 billion, on a daily average basis--approximately the average monthly increase in July and August--or at about a 17.0 per cent annual rate. The September increase resulted primarily from a much less than seasonal decline in outstanding CD's. Moreover, inflows of consumer-type time and savings deposits expanded at a slightly higher rate than the increased pace of August.

AVERAGE WEEKLY CHANGE IN TIME AND SAVINGS DEPOSITS
Weekly Reporting Banks
(Millions of dollars, not seasonally adjusted)

	1968				1967	1966
	June	July	Aug.	Sept.1/	Sept.1/	Sept.1/
Total time & savings deposits	- 79	512	462	- 69	-138	-268
Consumer-type deposits	101	101	121	150	158	93
Savings deposits	47	-77	-1	16	50	- 24
Time deposits, IPC (other than CD's, IPC)	54	178	112	134	108	117
Negotiable CD's	- 68	436	213	-157	-281	-325
All other time deposits2/	-112	-25	128	- 62	- 15	- 26

1/ All September figures include only the first three weeks in the month.
2/ Consists primarily of time deposits held by state and local governments and by foreign institutions.

With the recent slowing of loan demand and with the large volume of CD's outstanding, banks allowed their CD's to decline during the first three weeks in September. However, this reduction--about two-thirds of which occurred at New York banks--was only about half the size of declines in comparable periods of other recent years, and in the week ending September 25, banks in New York and Chicago added nearly $300 million to their outstandings. Throughout most of the month, moderate reductions were posted in offering rates on all but the shortest-maturity CD's. Following the more widespread decline in prime lending rates that occurred late in the month, major New York banks are reported to have reduced their offering rates to 5.50 per cent on CD's maturing in three months or less, and to 5.625 on CD's maturing in more than three months--somewhat lower than the rates reported in the latest survey (September 25).

Consumer-type time and savings deposit inflows at large banks improved somewhat further in September after having shown a slightly higher rate of growth in August than had prevailed in the previous two months. Most of the September increase in these deposits reflects inflows of time certificates and open accounts, which were larger than in comparable periods of most other years, and than in recent months of this year. Savings deposit inflows at large banks also improved in September, although they still remained below those in comparable periods of most recent years.

With the cost of Euro-dollars still attractive relative to that of CD's in September, banks continued to rely heavily on the Euro-dollar market for funds through the tax date. Over the three weeks ending September 18, bank liabilities to foreign branches rose about $550 million, following an increase of nearly $900 million in August. In the week ending September 25, however, these liabilities fell $500 million, bringing the current level back to about $7.1 billion.

Following the moderate August increase, the money stock, on a daily average basis, is estimated to have declined at a 5.5 per cent annual rate in September. This reduction--which reflects primarily a shift from private demand deposits into U.S. Government deposits to meet tax payments--brings the growth in the money stock over the third quarter down to a 4.5 per cent annual rate.

Over the past twelve months, the money stock has risen by about 5.8 per cent, as compared with an estimated 9.0 per cent increase in GNP, measured in current dollars. Although all other liquid assets held by the public (time and savings deposits at commercial banks and mutual savings banks, savings and loan shares, U.S. Government savings bonds, and U.S. Government securities maturing within one year) increased more rapidly than the money stock over this period, they also expanded less than GNP, resulting in a rather steady decline in the ratio of total liquid assets to GNP.

Nonbank depositary intermediaries. In August, there was only limited recovery in net savings inflows to the mutual savings banks and the savings and loan associations, despite the general downtrend of market interest rates. The absence of greater strength in inflows may reflect the sharp decline in the personal savings rate during the third quarter that accompanied the increase in withholding tax payments. However, data lags make it difficult to assess the current pace of inflows to these intermediaries.

GROWTH IN SAVINGS AT NONBANK DEPOSITARY INTERMEDIARIES
(Seasonally adjusted annual rates in per cent)

	Mutual Savings Banks	Savings and Loan Associations	Total
1967 - QI	9.8	9.4	9.5
II	11.0	11.4	11.3
III	8.6	9.8	9.4
IV	6.7	5.8	6.1
1968 - QI	7.5	5.7	6.2
II	6.7	5.9	6.1
July	5.7	4.4	4.8
August p/	6.1	6.5	6.4

p/ Preliminary.

During the September grace days of the current reinvestment period, the largest New York City mutual savings banks are reported to have experienced only minimal outflows. During the past several reinvestment periods, however, the experience during the early "grace" days has proven an unrealiable indicator of the over-all experience. Unfortunately, little additional information is expected prior to the FOMC meeting.

Liquidity ratios of savings and loan associations declined much more than seasonally in July and August, reaching their lowest levels since the end of 1966. This development reflects the lower minimum liquidity requirements announced by the FHLBB in July, and no doubt helped sustain S&L mortgage lending activity during July and August. With outstanding commitments already high relative to recent cash flows available for mortgage investment, some further reduction in liquidity seems probable unless savings flows pick up.

Mortgage market developments. Limited evidence suggests that the residential mortgage market again eased slightly during September, especially in the secondary market dominated by the more diversified types of lenders. Although the volume of 6-month bids accepted by FNMA in its forward commitment auction declined during the month as a whole, implicit yields on auctioned FHA and VA home mortgages continued to edge down, as the table shows. In addition, improvement in the availability of mortgage credit is suggested by a further seasonally adjusted uptrend in weekly applications to FHA for insurance of existing home mortgages through the week ended September 26, the latest available date.

FNMA WEEKLY AUCTIONS
(6-month forward commitments)

Auction date	Accepted bids ($ millions)	Implicit private market yields (per cent)
1968 - High		
June 10	44.8	7.71
August 5	49.7	7.32
12	43.4	7.31
19	37.4	7.27
26	37.0	7.24
September 3	37.6	7.23
9	39.0	7.22
16	29.9	7.19
23	21.0	7.17
30	24.8	7.16

Note: Average secondary market yield after allowance for commitment fee and required purchase and holding of FNMA stock, assuming prepayment period of 15 years for 30-year Government-underwritten mortgages. Yields shows are gross, before deduction of 50 basis point fee paid by investors to servicers. The first auction date was May 6.

These fragmentary developments imply a continuance during September of the slightly easing supply pressures now confirmed by official data for August. Reflecting in part the sustained volume of mortgage acquisitions by thrift institutions associated with a reduction in liquidity positions and slightly greater savings inflows in August, plus anticipations of further improvements in cash flows, yields on conventional home mortgages in the lagging primary market remained unchanged in August for the first time in 6 months. This followed a marked rise earlier in the year which was abetted by upward revisions in usury ceilings in some Eastern States.

In the more sensitive secondary market, moreover, yields on certain FHA-insured home mortgages declined during August for the second consecutive month, as the table shows. Average discounts required by lenders on these Government underwritten mortgages dropped further to 5 points. Although this was the lowest level in more than a year, it was still high enough to discourage some financing under the regular FHA-VA home loan insurance programs.

AVERAGE RATES AND YIELDS ON SELECTED NEW-HOME MORTGAGES

	Primary Market: Conventional loans		Secondary Market: FHA-insured loans		
	Level (per cent)	Yield spread (basis points)	Level (per cent)	Yield spread (basis points)	Discount (points)
1967					
August	6.55	66	6.60	71	5.2
September	6.55	67	6.63	75	5.4
October	6.55	43	6.65	53	5.6
November	6.65	12	6.77	24	6.5
December	6.70	19	6.81	30	6.8
1968					
January	6.75	51	6.81	57	6.8
February	6.75	46	6.78	49	6.6
March	6.80	24	6.83	27	7.0
April	6.90	38	6.94	42	7.9
May	7.15	49	7.50e	84e	6.1e
June	7.25	60r	7.52	87r	6.3
July	7.30	76	7.42	88	5.5
August	7.30	104	7.35	109	5.0

Note: FHA series: interest rates on conventional first mortgages (excluding additional fees and charges) are rounded to the nearest 5 basis points; secondary market yields and discounts are for certain 6 per cent, FHA-insured Sec. 203 loans through April with data for May 1968 estimated by Federal Reserve based on the new 6-3/4 per cent regulatory rate. Gross yield spread is average mortgage return, before deducting servicing fees, minus average yield on new issues of high grade corporate bonds.

Since average yields on new issues of high grade corporate bonds declined considerably during August, gross yield spreads favoring home mortgages widened sharply to the largest margins in a year and a half. Even so, yields on home mortgages undoubtedly remained considerably less attractive than returns on multifamily or commercial mortgages, some of which carry equity-type participations as well.

In August, the aggregate dollar volume of outstanding mortgage commitments of all savings and loan associations and New York State savings banks again increased slightly, on a seasonally adjusted basis, to reach a new high 3 per cent above the spring peak and a seventh above a year earlier. At least for reporting savings banks, nearly all (86 per cent) of the year-over-year increase reflected an expansion in long-term commitments scheduled to mature more than 9 months later. During the same period, commitments likely to be taken down over the near term to finance new or existing properties rose very little.

Corporate and municipal bond markets. Yields on new corporate bonds changed little on balance during September and at month-end remained almost 15 basis points above their August lows. Municipal yields, however, have declined about 10 to 15 basis points over the past three weeks, erasing nearly one-half of their August to early September advance.

BOND YIELDS
(Weekly averages, per cent per annum)

	Corporate Aaa New With call protection	Corporate Aaa Seasoned	State and local Government S&P High Grade	State and local Government Bond Buyer's (mixed qualities)
1968				
Low	6.12 (2/2)	5.95 (9/13)	4.15 (8/9)	4.07 (8/9)
High	6.83 (5/24)	6.29 (6/7)	4.68 (5/24)	4.71 (5/24)
Week ending:				
Aug. 16	6.13	6.00	4.29	4.22
23	6.13	5.98	4.34	4.27
30	6.13	5.97	4.45	4.38
Sept. 6	6.23	5.95	4.48	4.44
13	6.29	5.95	4.43	4.43
20	6.25	5.98	4.45	4.35
27	6.26	6.00	4.40	4.30

* - Some issues included carry 10-year call protection.

Bond markets had come under pressure in late August as the previous expectation for a sharp moderation in economic growth during the third quarter was shaken by a rash of bullish economic statistics. During September, however, corporate yields generally stabilized as underwriters were willing to hold the line on reoffering yields in view of the continuing moderate volume of new issues. But their inventory position began to rise as the distribution of many new issues proved sluggish. This development reflected the large volume of attractively priced competing instruments--such as the $250 million World Bank issue and an equally large FNMA offering--and the failure of prime rate reductions late in the month to spur investor interest in new issues at prevailing yields. Most recently, the over-all market weakened when underwriters reduced their inventory with the termination of syndicate price restrictions on a sizable, slow moving offering.

The ultimate volume of publicly-offered corporate bonds in September--at $725 million--showed little change from that estimated earlier. Although this placed September offerings about $100 million above the August seasonal lull, this level of issues nonetheless represents a significant decline from the average volume of such offerings earlier this year. Including private placements, total corporate security offerings in September, are estimated to have aggregated $1.7 billion--a small decline from the average monthly volume so far this year.

CORPORATE SECURITY OFFERINGS 1/
(Millions of dollars)

	Bonds				Total bonds and stocks	
	Public Offerings 2/		Private Placements			
	1967	1968	1967	1968	1967	1968
QI monthly avg.	1,088	822	604	575	1,821	1,726
QII monthly avg.	1,339	1,035	489	548	2.069	1,901
QIII monthly avg.	1,534	875e	517	620e	2,277	1,837e
August	1,813	615e	412	600e	2,481	1,565e
September	902	725e	647	700e	1,763	1,725e
October	1,375	850e	566	600e	2,409	1,750e

e/ Estimated.
1/ Data are gross proceeds.
2/ Includes refundings.

Flotations of corporate bond offerings in October are expected to increase from the volume of public issues in September and are tentatively estimated at $850 million. Although offerings remain below the previous outsized volume, they still are relatively large. Public utility companies have been financing in record volume this year and the forward calendar continues to carry a sizable number of such issues. In addition to these offerings, there are a notable number of issues by small to medium size manufacturing corporations that have partially offset the reduced number of large offerings by prime industrial borrowers. At least some of these offerings may represent financing that was deferred earlier when the calendar was pre-empted by prime companies. Many of these non-utility offerings carry convertible features as some borrowers are taking advantage of the more favorable stock market outlook indicated by the recent rise in stock prices. The total volume of corporate security offerings in October, however, will likely be unchanged from September--at $1.7 billion--as a seasonal decline in privately placed bonds will offset the expected rise in public bond offerings.

In the municipal market the September downturn in yields was primarily a reflection of strong bank demand. With sizable time deposit inflows coupled with relatively modest business loan demand, commercial banks reportedly have continued to acquire municipal securities at a rapid rate.

Municipal bond new issue volume has fluctuated sharply from month-to-month as some large offerings have been shifted on the calendar. The estimated volume for September has been reduced to $1,250 million, placing September more than $400 million below August. Over one-half of this decline is attributable to the temporary delay in bringing a negotiated revenue bond issue--now scheduled for October--to market. The October volume will show a sharp jump to about $1.6 billion and may well include at least five issues of $100 million or larger in size.

The increased volume of industrial revenue bond issues over the past few months in large measure accounts for the rise in municipal offerings, and more than one-fifth of the October calendar represents such financing. At year end, when all but the smallest issues of such bonds will become taxable, industrial revenue financing is expected to become minimal.[1/]

1/ A rider to a bill currently in House-Senate Conference Committee would raise the issue size exempt from Federal income taxes to $5 million--from the $1 million limit imposed earlier this year. While issues under $5 million represented 74 per cent of total industrial offerings in 1967, they constituted only 13 per cent of dollar volume.

STATE AND LOCAL GOVERNMENT BOND OFFERINGS
(Millions of dollars) 1/

	1967	1968
QI monthly average	1,391	1,240
QII monthly average	1,294	1,268
QIII monthly average	1,050	1,461e
August	860	1,683
September	1,340	1,250e
October	975	1,600e

e/ Estimated.
1/ Data are for principal amounts of new issues.

Stock market. On sharply increased trading volume, the advance in common stock prices since late August has carried the major market price indices slightly above the historic highs reached in mid-July. The recent rise in stock prices has apparently been associated in part with increased institutional purchases--as indicated by the increase in large block transactions after a sharp decline in such purchases in August. Mutual funds, in particular, had been reportedly in a very liquid position over the summer months and hence in a position to increase their market activity. More generally, however, the continued indications of strong economic growth, and press reports of upward revisions of GNP forecasts, have probably played a key role in the reevaluation of stock market values in recent weeks.

STOCK PRICES

	Dow Jones Industrials	New York Stock Exchange Index	American Exchange Index
Mid-July high	923.72	57.69	30.08
Early-August low	869.65	54.18	28.82
Per cent decline from mid-July to early August	-5.9	-6.1	-4.2
October 1	942.32	57.81	30.77
Per cent rise from early August to October 1	8.4	6.7	6.8

For the second consecutive month, margin debt at brokers declined in August by $120 million; this reduction in debt, coupled with the modest increase in stock prices on the New York Stock Exchange, led to a slight increase in customers' equity in their margin accounts with brokers. Bank purpose loans at reporting banks--which unfortunately include some loans on corporate bonds--increased by $60 million in August.

The back-office problems of brokerages, although somewhat improved, were apparently still large enough to force continuance of Wednesday Exchange closings at least through October 9. The New York Exchange, however, has implied that a return to a 5-day week may soon be possible.

AVERAGE DAILY TRADING VOLUME
(In millions of shares)

	New York Stock Exchange	American Stock Exchange
July	14.3	6.6
August	10.8	4.8
Week ending:		
September 6	11.4	5.7
13	12.7	6.1
20	14.8	7.2
27	14.9	6.7

Government securities market. Since the discount rate cut in mid-August, yields on Treasury bills have fluctuated considerably but without any decisive trend. From their high to their low points, these variations have ranged generally from 10-20 basis points. Yields on coupon issues have also fluctuated, although characteristically by smaller amounts, generally in the same direction as bill yields.

This indecisive pattern of change reflects the wait-and-see attitude now generally prevalent among market participants regarding the likely future course of economic activity and interest rates. Movements that have occurred, while partly seasonal, have been accentuated by special factors such as the unexpectedly large drain on the Treasury balance at the Federal Reserve prior to the quarterly corporate tax payment date. In addition, yields have continued to respond to any developments which seemed, even temporarily, to increase or decrease the odds that earlier market expectations of lower interest rates later in the year will in fact be realized.

MARKET YIELDS ON U. S. GOVERNMENT SECURITIES
(Per cent)

		1968				
		Aug. 5 1/	Aug. 13 2/	Sept. 10 3/	Sept. 26	Oct. 1
Bills						
1-month	5.70 (5/21)	4.95	5.00	5.18	5.12	5.19
3-month	5.92 (5/21)	4.89	5.11	5.30	5.09	5.21
6-month	6.08 (5/21)	5.12	5.28	5.33	5.22	5.32
1-year	6.03 (5/21)	5.04	5.22	5.26	5.12	5.20
Coupons						
3-years	6.36 (5/21)	5.41	5.47	5.47	5.40	5.43
5-years	6.21 (5/21)	5.48	5.52	5.54	5.45	5.48
10-years	6.02 (5/21)	5.37	5.43	5.51	5.45	5.49
20-years	5.77 (3/14)	5.16	5.24	5.31	5.28	5.33

1/ Summer lows. 2/ August Committee meeting.
3/ September Committee meeting.

Early in September, Treasury bill yields had drifted higher, raising the quote on the three-month issue to a recent high of 5.30 per cent at the time of the last Open Market Committee meeting. In this period, continued high financing costs and heavy System selling--both for its own and foreign accounts--had encouraged dealers to try to lighten their positions. The magnitude of System selling was augmented because the unexpectedly large drains on the Treasury balance at Federal Reserve Banks increased the System's need to absorb reserves. At the same time market participants were assuming a generally cautious attitude because they were unsure how strongly money market pressures would be accentuated by business demands on banks stemming from the added burden on corporations created by the June tax legislation.

The absence of unusual market pressures around the tax date; the switch of Desk operations to the buy side of the market as the Treasury balance was replenished; the reappearance of demands for bills from other investors (partly in anticipation of the quarterly statement date at banks); and the general easing of money market conditions that developed in the period of transition to the new lagged reserve adjustment system--all contributed to declines in bill yields during the middle weeks of September. Most recently, however, with day-to-day money market conditions showing a tendency to tighten again and with dealers beginning to look ahead to large Treasury cash and refinancing operations, Treasury yields have turned up. The yield on three-month bills rose from 5.09 per cent on September 26 to 5.21 per cent in early October. Recent rate changes on other short-term market instruments have all been downward, however, as the table shows, reflecting the usual tendency of such rates to lag behind changes in Treasury bill yields.

With the period of large forthcoming Treasury financing operations becoming more imminent, dealers have made some further progress in reducing their holdings of Treasury coupon issues. But their aggregate holdings of longer-term issues are still quite sizable.

DEALER POSITIONS IN GOVERNMENT SECURITIES
(Millions of dollars)

	August 8	September 10	September 30
Total	5,892	4,994	4,503
Treasury bills	3,650	3,358	3,422
Coupon Issues	2,242	1,636	1,181
Due within 1 year	777 1/	442	310
1-5 years	327	259	167
over 5 years	1,138	935	704

1/ Includes nearly $400 million of maturing August issues which were subsequently used to cover dealer commitments on the new 5-5/8 per cent note; in effect this amount represents double counting.

SELECTED SHORT-TERM RATES

	1967 Highs	1968 Lows	1968 Highs	Aug. 13	Sept. 10	Oct. 1
1-month						
CD's (prime NYC)						
Highest quoted new issue	5.50 (12/29)	4.88 (2/8)	5.50 (8/29)	5.50	5.50	5.50
Secondary market	5.50 (12/29)	4.75 (2/2)	6.20 (5/31)	5.80	5.75	5.55
3-month						
Bankers' acceptances	5.63 (12/29)	5.25 (3/7)	6.13 (5/24)	5.75	5.62	5.62
Federal agencies	5.30 (12/29)	5.00 (2/9)	6.11 (5/17)	5.45	5.45	5.41
Finance paper	5.88 (1/6)	5.13 (3/7)	6.13 (6/25)	5.75	5.62	5.50
CD's (prime NYC)						
Highest quoted new issue	5.50 (12/29)	5.25 (2/8)	6.00 (7/18)	5.75	5.75	5.62
Secondary market	5.70 (12/29)	5.20 (1/31)	6.20 (5/31)	5.85	5.85	5.65
6-month						
Bankers' acceptances	5.75 (12/29)	5.40 (3/7)	6.25 (5/24)	5.88	5.75	5.75
Commercial paper	6.00 (1/6)	5.50 (3/7)	6.25 (7/25)	5.88	5.88	5.75
Federal agencies	5.55 (12/29)	5.25 (2/9)	6.25 (5/24)	5.49	5.56	5.53
CD's (prime NYC)						
Highest quoted new issue	5.50 (12/29)	5.50 (3/7)	6.25 (7/11)	5.75	5.75	5.62
Secondary market	6.00 (12/29)	5.45 (1/31)	6.40 (5/31)	5.90	5.90	5.75
1-year						
Federal agencies	5.95 (12/29)	5.50 (3/1)	6.01 (5/31)	5.55	5.60	5.59
Prime municipals	4.00 (12/29)	2.75 (8/8)	3.90 (5/31)	2.75	2.90	2.85

N.B. - Latest dates on which high rates occurred are indicated in parentheses.

Federal finance. On the basis of daily Treasury data and monthly statements through August, Federal expenditures are estimated to have leveled off significantly during the third quarter of 1968 following large increases in earlier quarters. Early in the third quarter, the spending level was raised $1.6 billion by Federal pay raises, and present estimates indicate an over-all increase of $3.9 billion for the full quarter.

FEDERAL SPENDING -- NIA ACCOUNTS
(Seasonally adjusted at annual rates)

	Amount	Increase		
	QII 1968	QI and QII	QIII est. 1/	Remainder of Fiscal Year as implied by Summer Budget Review 2/
Total	181.9	13.3	3.9	-.4
Defense	79.0	4.4	1.5	-1.7
Nondefense	102.9	8.9	2.4	1.3

1/ Third quarter includes effect of July Federal pay raise, which is estimated at $1.1 billion for defense and $0.5 billion for non-defense.

2/ Compares average of the three remaining quarters with estimates for QIII 1968. Budget concepts were translated by Board staff into NIA basis. Data do not allow for an additional increase of $1.0 billion in nondefense expenditures that would be likely if the House confirms recent Senate action exempting CCC price-support payments from the Budget ceiling.

Defense purchases are estimated to have increased by $1.5 billion in the third quarter, but to meet the Summer Budget Review projection they would have to decline moderately during the remainder of the fiscal year. While an actual decline in defense is considered unlikely by some forecasters, a leveling out in defense spending would be consistent with the behavior of advance indicators, such as data on obligations and contracts.

Nondefense expenditures increased by an estimated $2.4 billion in the third quarter, and moderate further increases are expected during the remainder of the fiscal year even if Congress does not allow additional exemptions, such as that discussed for CCC price-support.

As regards the immediate outlook for financing needs, the Treasury entered the month of October with a higher than normal operating balance of $8.6 billion. The balance had increased during September, as sizable corporate tax payments were collected. To cover the large, mainly seasonal, deficit projected for October, the Treasury is expected to raise about $3.5 billion in tax bills before announcing the November refunding in the latter part of October. The public holds about $4.0 billion of notes and bonds that mature in mid-November and another $1.6 billion of bonds that mature mid-December. The latter issue is expected to be included in the November refinancing. The projected cash financing in October will need to be supplemented by one additional cash borrowing operation before the end of the fourth quarter.

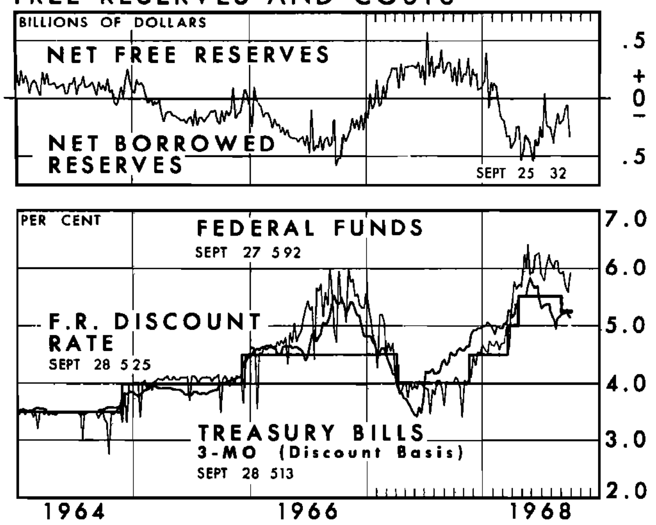
PROJECTION OF TREASURY CASH OUTLOOK
(In billions of dollars)

	September[a/]	October	November-December
Borrowing operations			
New cash raised			
Weekly bills	.4	.2	--
Tax bills	--	3.5	3.0
Coupon issues	--	--	--
PC's	--	--	--
Debt repayment, etc. (-)	.3	- .1	--
Total net borrowing from public	.7	3.6	3.0
Plus: Other net fin'l. sources[b/]	1.2	.1	- .8
Plus: Budget surplus or deficit (-)	2.1	-5.1	-3.6
Equals: Change in cash balance	4.0	-1.4	-1.4
Memorandum: Level of cash balance end of period	8.6	7.2	5.8

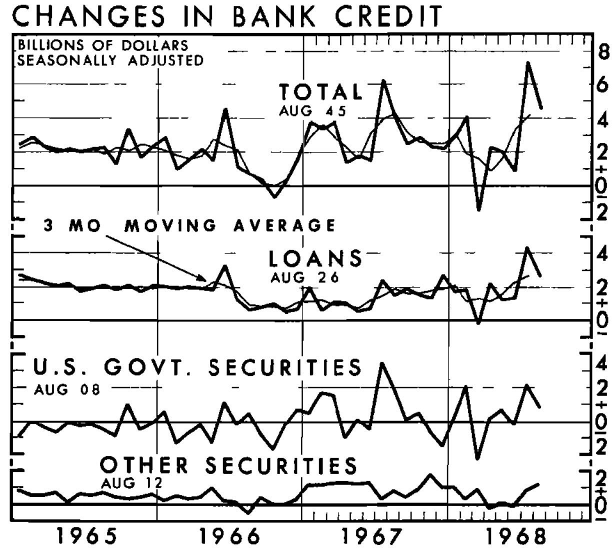
a/ Actual and estimated data.
b/ Checks issues less checks paid and other accrual items.

FINANCIAL DEVELOPMENTS - UNITED STATES

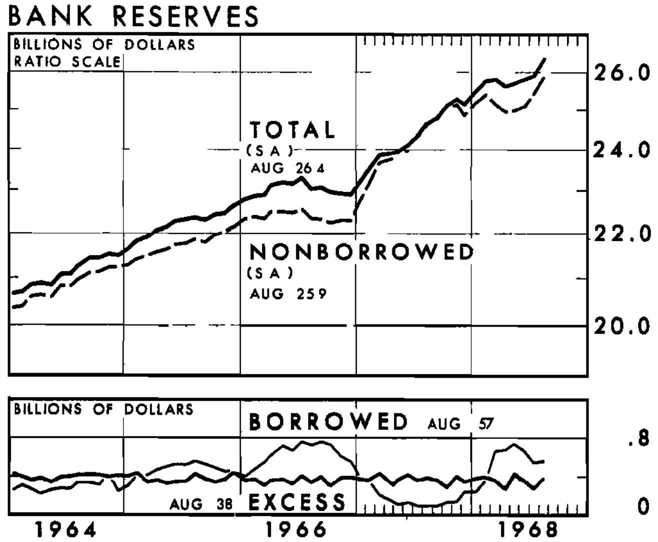
FREE RESERVES AND COSTS



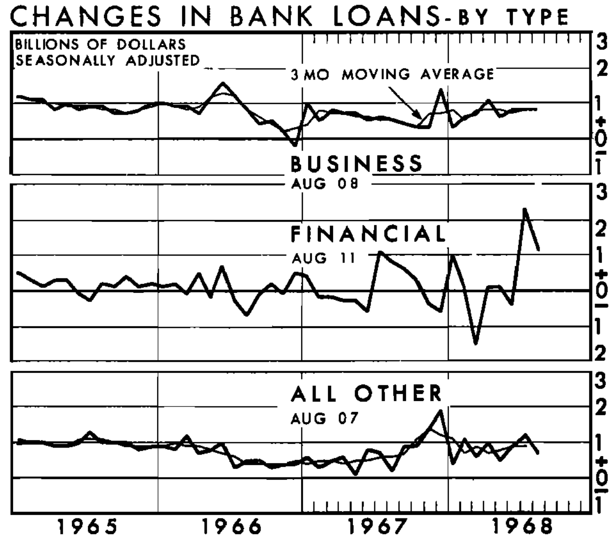
CHANGES IN BANK CREDIT



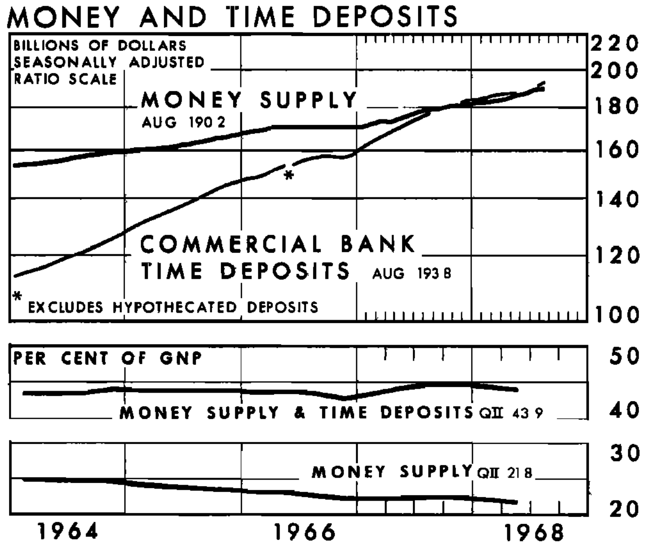
BANK RESERVES



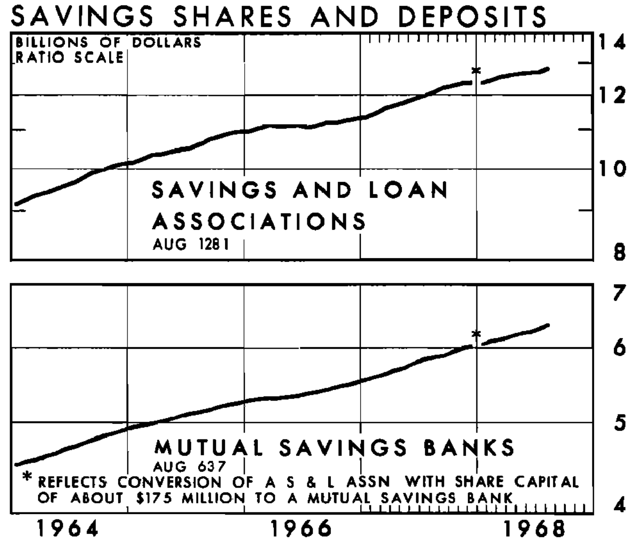
CHANGES IN BANK LOANS-BY TYPE



MONEY AND TIME DEPOSITS

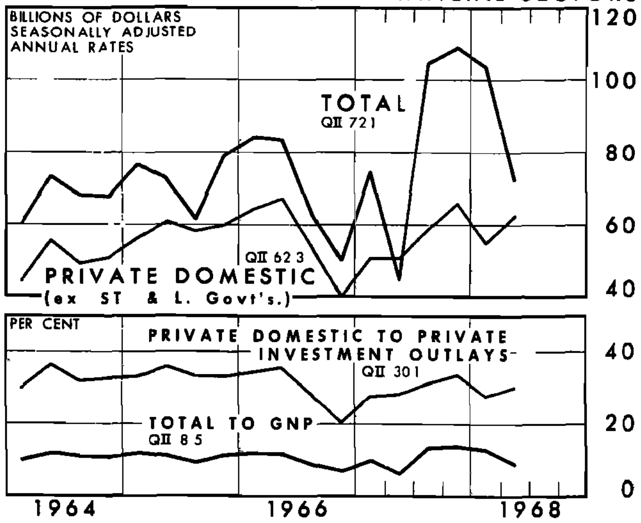


SAVINGS SHARES AND DEPOSITS

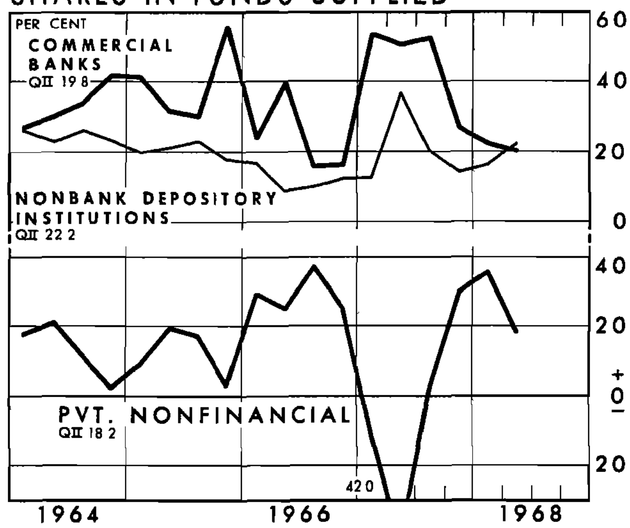


FINANCIAL DEVELOPMENTS - UNITED STATES

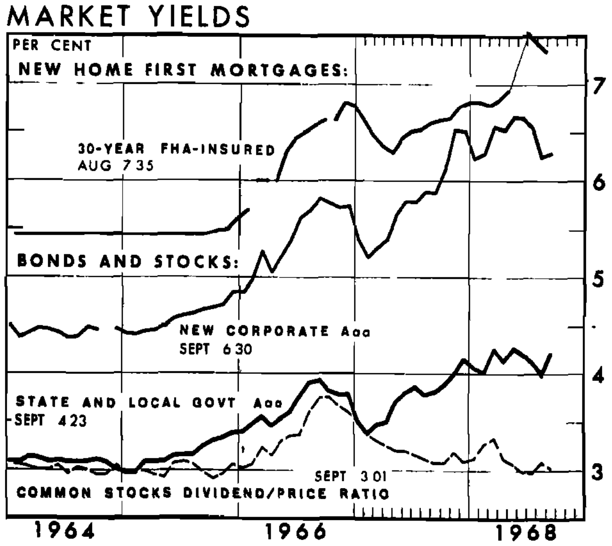
NET FUNDS RAISED-NONFINANCIAL SECTORS



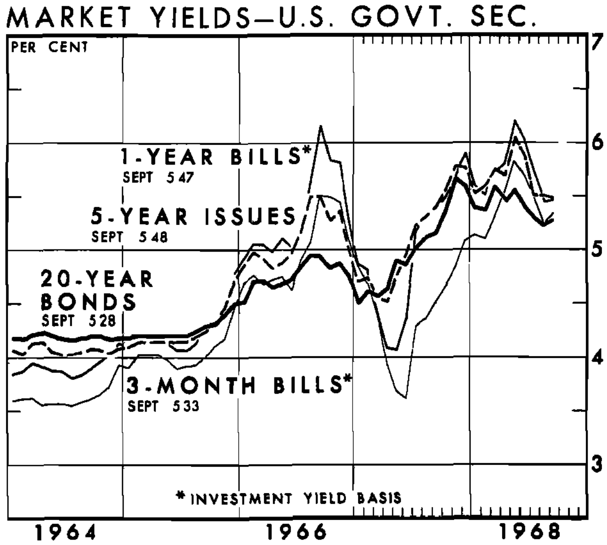
SHARES IN FUNDS SUPPLIED



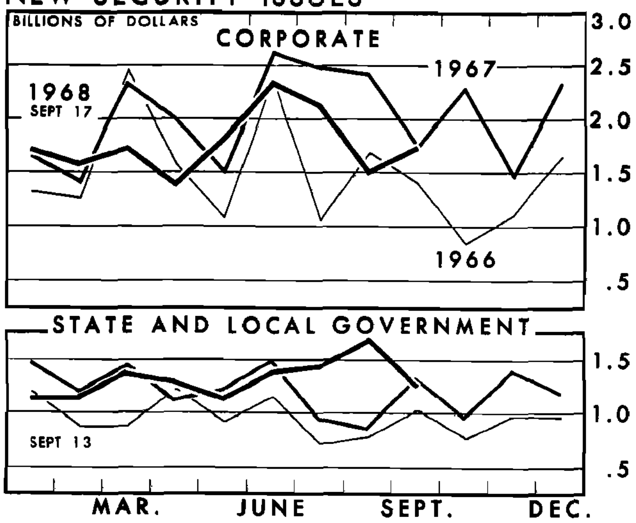
MARKET YIELDS



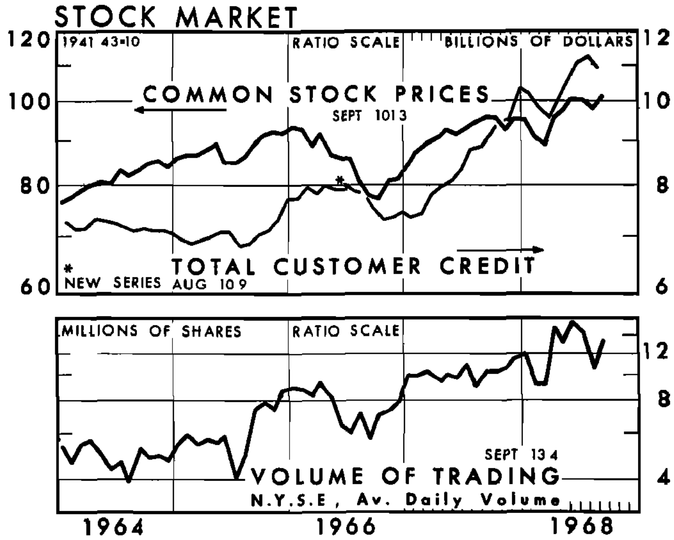
MARKET YIELDS—U.S. GOVT. SEC.



NEW SECURITY ISSUES



STOCK MARKET



INTERNATIONAL DEVELOPMENTS

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U.S. foreign trade	- 7
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Exchange market and gold developments. During the last three weeks of September the general atmosphere in exchange markets improved considerably, as rumors of a German mark revaluation subsided. The Bundesbank's market purchases of dollars in the last three weeks of the month totaled about $260 million, while its swaps with German banks (in which it sells dollars spot and buys dollars forward) came to $390 million, compared to nearly $1.7 billion in market purchases and $1.2 billion in swaps between August 26 and September 6. The market atmosphere, however, remains unsettled, and the possibility of renewed speculative buying of marks will probably remain real for some time to come.

Sterling advanced sharply on September 9 on the news that the final arrangements for the sterling balances assistance package for the British had been successfully negotiated at Basle; sterling was given a further boost at mid-month when the British trade figures for August were released. The spot exchange rate for the pound advanced from about $2.3830 on September 6 to about $2.3900 today (October 2), and the discount on three-month forward sterling declined from around 2.8 per cent per annum in the first week of September to about 1.6 per cent by month-end. Even though there was a moderate decline in U.K. local authority deposit rates relative to Euro-dollar rates during the month, the narrowing of the discount on forward sterling was sufficient to reduce the covered margin in favor of Euro-dollars from nearly 120 points in the first week of September to about 35 points on October 1.

The French franc remained under severe selling pressure until the last week of September when a marked easing of the pressure occurred. Bank of France net sales of dollars between September 23 and 30 were far smaller than earlier.

Gold market activity picked up beginning September 27 and prices were marked down substantially in the course of the next several days. Earlier, prices had advanced from just under \$40.00 to about \$40.50. By Wednesday, October 2, the second fixing price in London was reduced to \$38.90. Knowledge that the South African gold policy issue would be under discussion at this week's IMF meeting no doubt has influenced the market.

Euro-dollar market. U.S. banks increased their use of Euro-dollar funds during August and until after mid-September, enlarging their liabilities to overseas branches by \$765 million between August 14 and September 18. Interest rates in the Euro-dollar market tended to rise in the latter part of August but declined substantially during most of September, as large supplies of funds came to the market as a result of movements out of sterling and French franc assets on the part of private holders.

Despite an unusually wide cost differential favoring use of Euro-dollar funds by U.S. banks, in the week ended September 25 the U.S. banks reduced their liabilities to branches by about $500 million, apparently reacting to the increased availability of alternative domestic sources of funds after the mid-September tax date. Since then Euro-dollar rates have risen (the call rate from 5-3/8 to 5-7/8 per cent, and the 3-month rate from under 5-3/4 to 6-1/8 per cent) and New York banks have further reduced their liabilities to branches.

<u>U.S. balance of payments</u>. In the quarter just ended the liquidity deficit -- seasonally adjusted and before special transactions -- seems to have registered an annual rate of about $3 billion, compared to a rate of $3.8 billion in the first six months of the year. Since the figures for September are incomplete, the third quarter result is still tentative. Special transactions (detailed in Appendix B) have been exceptionally large, totalling nearly $500 million in the third quarter and over $1.5 billion for the first nine months. The previous high for such transactions for a full year was $1.6 billion in 1966. For the first nine months of 1968 the liquidity deficit before special transactions was at an annual rate of $3-1/2 billion, compared to a $4.3 billion rate in the same period last year.

The seasonally adjusted liquidity deficit for the first nine months of the year in its published version -- <u>after</u> taking credit for special transactions -- was at an annual rate of about $1-1/2 billion, compared with a comparable annual rate of $2.4 billion in 1967. Last year the published liquidity deficit in the fourth quarter was extraordinarily large, partly because of the final liquidation of $540 million of U.K. official investments in the U.S.

Measured on the official settlements basis there was a surplus of perhaps $400 million in the third quarter, seasonally adjusted. Special transactions have not significantly affected this balance. Again, there is considerable uncertainty because the September figures are incomplete and the seasonal adjustments somewhat questionable. Of course, this balance has gyrated widely during the year, registering very large surpluses in May and June as U.S. banks absorbed via their foreign branches a substantial part of the speculative drain on French and British reserves, coming to near balance in July and August, and moving into a moderate surplus again in September.

Favorable elements in the third quarter transactions included some improvement in the trade balance (discussed below) and probably also a considerable reduction in capital outflows for direct foreign investment as well as a reduced accmumulation of liquid funds abroad, as the proceeds of foreign borrowing were increasingly substituted for funds from U.S. sources. Although the reduction of U.S. banking claims on foreigners was interrupted in August by a small net outflow, contrary to the usual seasonal pattern, this reflected primarily large acceptance credits to Brazil, while the general trend was still inward.

As shown in the following table, the net inflow of foreign private capital and short-term funds in the first half of this year amounted to $5.3 billion (not seasonally adjusted), including $2.4 billion to acquire nonliquid assets and $2.9 billion of interbank balances and deposits in U.S. commercial banks and other liquid assets. These inflows had already reached major proportions in 1966 compared to prior periods. For example, in the six years 1960-65, the average annual net inflow of private foreign capital was about $900 million -- about one third for long-term investment and two-thirds for liquid holdings in U.S. banks. But the 1968 inflow has been more than double the 1966 rate.

PRIVATE FOREIGN CAPITAL FLOWS IN THE U.S. BALANCE OF PAYMENTS 1/
(in millions of dollars; outflows (-))

			1968			
	1966	1967	Q-I	Q-II	July	Aug.
Net capital inflow, total	4,164	3,678	1,756	3,562	n.a.	n.a.
Net purchases of U.S. corp. stocks 1/	93	811	285	528	198	100
Net purchases of U.S. corp. bonds 1/	603	511	444	585	136	110
Of which: issued to finance direct foreign investments	(594)	(446)	(533)	(554)	(150)	(176)
Direct investment in the U.S.	86	250	256	-3	n.a.	n.a.
Long-term liabilities of non-banks 1/	180	89	154	36	n.a.	n.a.
Short-term liabilities of non-banks	298	388	-21	138	n.a.	n.a.
Long-term liabilities of U.S. banks	-3	-46	--	1	-14	n.a.
Total, items above	1,255	2,003	1,118	1,285	n.a.	n.a.
Short-term liabilities held at U.S. banks 1/	2,909	1,675	638	2,277	-65	624

Not seasonally adjusted.

1/ Excludes assets and investments in the U.S. by foreign official accounts and international agencies.

These figures emphasize the extent to which these inflows have been alleviating the recent balance of payments deficits -- expecially the official settlements balance which benefits from the great increase in privately held foreign balances in U.S. banks (but not from most of the "special" transactions excluded from this tabulation). Sales to foreigners of securities to finance direct foreign investments are a rather special case, in the sense that the gain to the balance of payments has to be measured in terms of the capital outflow that might otherwise be occurring -- as well as future income derived from the investment of the funds. With a mandatory control program in effect, the most direct gain from the availability of offshore financing is the safety valve provided for what would perhaps be intolerable pressures on the administration of the restraints. Sales of these securities tapered off in the third quarter to about $370 million from over $500 million in each of the previous two quarters. A considerable number of companies will probably borrow in the last months of the year to meet their ceiling under the Commerce control program, but by the end of September many major companies were well supplied with borrowed funds, and whether they enter the market again will depend partly on their anticipation of changes in borrowing costs in foreign markets in 1969. U.S. companies will also be speculating on the prospects for continuation of the control program under the same rules if the Administration changes. Early announcement of the 1969 program of the present Administration is planned so as to minimize any precautionary outflow.

Foreign investments in U.S. corporate stocks slackened a bit in August, but remained very high -- at about $100 million, net, -- by historic standards. The buildup of interbank balances and private deposits in U.S. banks -- largely via the foreign branches of the banks -- seems to have halted if not reversed (see page IV- above). This year's inflows of foreign capital, both for investment purposes and for more-or-less temporary lodging in commercial banks, have been so far different in magnitude from previous experience that expectations of their future course can only be conjectural.

<u>U.S. foreign trade</u>. The merchandise export surplus, very slim in July, shrank further in August as a sharp rise in exports was exceeded by an even greater rise in imports. The strong rise in both exports and imports was attributed, in part, to anticipation of an East Coast and Gulf Coast longshoremen's strike, which, in fact, did begin on October 1 but was stopped by action under the Taft-Hartley Act.

Port activity on the East Coast was reported to be extremely heavy in September, particularly for outbound cargo, suggesting that September exports may have been even greater than August's. At the time of the last longshoremen's contract negotiations, exactly 4 years ago in 1964, it was estimated that accelerated cargo movements from September through December, including the period when a Taft-Hartley injunction was in effect, were twice as great in exports, favorably affecting the export surplus then by close to a $1/2 billion at an annual rate. This was followed, however, by a much larger loss of net exports as a result of the 61-day work stoppage that began in early January 1965.

For July-August combined, the export surplus (balance of payments basis) was $0.7 billion at an annual rate, compared to the $0.2 billion rate in the first half of the year.

Exports in July-August were at an annual rate of $33.9 billion (balance of payments basis), about 4-1/2 per cent higher than in the first six months of 1968. Exports of nonagricultural products were up nearly 6 per cent, continuing the expansion which began before the end of 1967. Shipments of agricultural commodities in July-August, although up from the preceding two months, were nevertheless slightly below their average level in the first half of the year. Exports of tabacco, ordinarily heavy in the autumn, were advanced to August this year under the threat of the longshoremen's strike. Cotton shipments (in July) were also up, reflecting late deliveries under contracts made earlier in the year.

By areas, the greatest gains in exports in July-August continued to be in shipments to continental Western Europe, particularly the EEC countries. Shipments to the U.K., Japan and Latin America also expanded, but more moderately, while exports to Canada continued to slide.

<u>Imports</u> in July-August held at the record second-quarter annual rate of $33.2 billion (balance of payments basis). The strong rise in August, following a drop in July, reflects in large part extraordinarily heavy arrivals of steel ordered earlier, some of which were delayed by the St. Lawrence Seaway strike (which ended in mid-July). Larger receipts of unrefined copper, bonded for refining and subsequent export, also contributed to the August rise. Exceptionally large imports of whisky were related to the prospective longshoremen's strike.

Arrivals of cars from Canada fell sharply in July and declined further in August; they appeared to be much lower than usual for a model changeover period. In contrast, imports of cars from Europe and Japan continued strong in July-August, and were at a rate nearly 20 per cent greater than in the second quarter. The heavy inventory buildup in such cars was arrested in August but the large stock liquidation which customarily occurs in that month did not take place this year with imports higher than usual.

Purchases of other nonfood consumer goods also increased in July-August, with both durable and nondurable types recording sharp advances. The continued expansion in imports of foodstuffs brought a further addition to coffee inventories.

<u>Economic activity in other industrial countries</u>. Industrial production in Western Europe, Japan, and Canada has continued to expand in recent months. Demand forces in the United States and Germany have been particularly influential in the current upswing, which began before mid-1967. Though the pace of increase of U.S. import buying may now slow, it is likely that domestic demand forces in Japan, France, and Italy, as well as in Germany, will assume a larger role. Canadian activity, however, is likely to keep more closely in step with U.S. demand.

INDUSTRIAL PRODUCTION IN MAJOR COUNTRIES
1963 - 100

	1967				1968			Percent increase
	Q-1	Q-2	Q-3	Q-4	Q-1	Q-2	June-July	Q-2 to Q-2
United Kingdom	110	110	110	113	115	115	116	5
Germany	111	110	114	120	119	126	129	14
France	119	118	120	123	125	105a/	...	9b/
Italy	127	128	125	131	133	136	...	6
Netherlands	126	127	130	135	139	141	...	11
Belgium	113	112	110	114	118	118c/	...	5c/
Sweden	125	127	128	130	129	130	...	2
Japan	151	157	166	174	177	187	191	19
Canada	129	130	131	132	132	136	...	5
United States	126	125	127	128	130	132	133d/	5

a/ Affected by strikes. April was 128.
b/ April to April.
c/ April-May average.
d/ June-August average.

The <u>German</u> economy at mid-1968 was nearing full employment, though far from the extreme boom conditions of 1965 -- any repetition of which the German authorities are determined to avoid. Following the sharp bulge in activity last December and the subsequent dip, expansion resumed in the spring and summer. In August the unemployment rate fell below one per cent and job vacancies were three-fourths again as large as the number of unemployed, seasonally adjusted. Rather wide fluctuations in production in the months of June and July resulted in part from efforts to beat the midyear increase in the value-added tax. Averaging the two months together, industrial production in June-July was 7 per cent above the October-March average, and 16 per cent above the low second quarter of 1967. According to a July survey, the rate of capacity utilization during the summer was 86 per cent, a rate considered normal by most producers though 3 points below the high capacity rates reached in 1965.

German exports in June-July were 11 per cent higher in value than in the second quarter of 1967. Meanwhile imports had risen 18 per cent, providing an important source of aggregate demand growth in neighboring economies. The narrowing of the German export surplus did not continue, however, in May-July, when exports rose somewhat more than imports.

German authorities have again revised their forecasts for 1968 upward, and now predict a rise in real GNP of 5-1/2 per cent over 1967. Demand has been expanding in all sectors of the economy: foreign orders in June-July averaged 6 per cent more than in October-March; inventory investment has continued at a higher rate than originally forecast; private capital spending plans are being revised upward; demand from the public sector remains strong; and private consumption, which earlier had lagged, rose strongly during the spring.

Fiscal and monetary policies are continuing to favor balanced expansion in Germany. The proposed 1969 budget seems calculated to put a mild brake on expansion; expenditures will increase by 5.4 per cent over 1968 -- less than the anticipated growth of GNP in current prices -- and the budget deficit will be cut from $1.8 billion in 1968 to $0.9 billion in 1969. Monetary policy is no longer actively expansionary but neither has the Bundesbank actively tightened credit. Market forces are being allowed to exert their influence upon bank liquidity and in both the first and second quarters this resulted in some withdrawal of bank liquidity. In its latest (August) Monthly Report, the Bundesbank reaffirms its view that there is still no reason to tighten monetary policy.

In Britain, economic activity has risen only moderately since last winter, after a sharp expansion in the first quarter of this year. In June-July industrial production was 1 per cent above the first quarter level. The National Institute's August forecast, which assumed a continuation of moderate expansion, projected a 3.3 per cent annual rate of increase in real GNP through the rest of 1968 and 1969.

The key factor of demand during the spring and summer was inventory investment, reflecting replenishment of stocks depleted by the consumer buying surge early in the year, as well as buying of materials in anticipation of further export growth and of a pickup in fixed investment. The swing from an absolute rundown of inventories in the first quarter to a rapid buildup in the second quarter was equivalent to 3 per cent of GNP. Inventory accumulation has probably been accentuated by uncertainty over the permanence of the $2.40 parity, inflation fears, and talk of import controls.

Personal consumpti n expenditures declined sharply last spring. The real volume of retail sales (excluding autos) in April-July was almost 3.5 per cent below the first quarter. Automobile registrations fell by about 40 per cent from the first to the second quarter.

Contributing to expansion of activity, British exports in April-July averaged 9 per cent larger in volume (i.e. adjusted for price changes) than in the six months October-March. The value of exports in current prices jumped further by 5 per cent from July to August, and it is likely that most of the increase was in real terms.

The government appears determined to keep a tight rein on consumer spending and to slow the rate of increase in public sector spending. The government most recently reaffirmed its commitment to restraint when it stressed that the lowering of the discount rate from 7-1/2 to 7 per cent on September 19 would not be accompanied by any easing of restrictions on domestic credit. British consumer prices have been rising more rapidly than wages since October 1967, in accordance with the government's strategy for transferring resources out of consumption. From March to June, prices rose by 2-1/4 per cent, wages about 3/4 of one per cent.

Labor disputes thus far this year have involved numerous small walkouts, especially in the auto industry, but no widespread disruption of the economy comparable to the effects of the dock strike a year ago. There is a possibility, however, that a strike that could do incalculable damage to Britain's exports may begin next month. Negotiations involving the 2.5 million manual workers in the engineering industry have reached an impasse and the 31 unions involved are threatening a mass walkout starting October 21.

Economic activity in France seems to have rebounded strongly in July and August from the depressed levels of May and June. Because of the nationwide strikes, industrial production in May was one-third below the April level, and in June output was still 20 per cent below April.

Average wage rates rose by about 10 per cent between April 1 and July 1, to a level 15 per cent higher than a year earlier. Price developments since the unrest have not been unsatisfactory; the consumer price index rose at an annual rate of 4 per cent from April to July, about the same pace as over the preceding 12 months. Larger increases are expected during the rest of the year, but the Government is attempting to limit these through agreements with manufacturers. The expected consumer boom is now under way. Retail sales at large stores and chains in July and August were 10 per cent above their year-earlier level. Surveys by INSEE and the Bank of France reveal very strong demand for consumer appliances and automobiles.

In the first eight months, French exports were 10 per cent higher than in January-August 1967. This rate of increase may accelerate over the next few months as exporters take advantage of export subsidies which will be reduced on November 1 and eliminated at the end of the year. Imports in the first eight months were 7.5 per cent higher than in the corresponding period last year, but it is expected that import demand will increase strongly as a result of rising consumption.

Fiscal policy has moved in an expansionary direction, and the 1969 deficit is expected to be larger than this year's. Real GDP in 1969 is expected to be 7 per cent above the 1968 average, making the two-year average rate of growth from 1967 to 1969 about 5 per cent. But this rate of growth will not be sufficient to absorb unused capacity in the economy, and unemployment is expected to be a serious problem next year. The government forecast is for price rises on the order of 4 per cent in 1969, but this seems too optimistic to many observers, particularly in view of the further wage increases at mid-1969 that have been promised. The government also expects a sizable current account balance of payments deficit.

The Bank of France has been restricting its accommodation to the market and maintaining unusually high interest rates, in order to check the speculation against the franc. The latest 3-month Treasury bill offering carried an interest rate of 7.75 per cent, almost 3 percentage points above the April level.

Economic growth in Italy has not proceeded quite as rapidly as had been forecast. Industrial production in the second quarter had risen at an 8 per cent annual rate from the fourth quarter of 1967 (following a rapid recovery after the mid-1967 pause). Aggregate demand was stimulated by sharply higher exports, while domestic demand was relatively sluggish. In particular, it appears from business surveys that producers were trying to reduce excessive inventories.

As the Italian economy had been expanding less rapidly than its potential, the Government, in late July, adopted a number of measures intended to provide further stimulus to aggregate demand. The more important of these measures are an investment tax credit and a labor-cost subsidy for firms in Southern Italy.

Economic activity in the Netherlands continued to advance in the second quarter, with exports a leading expansionary factor. Exports of both the Netherlands and Belgium were adversely affected by the troubles in France, but second-quarter output in Belgium was nevertheless substantially larger than at any time last year.

Economic growth in Sweden has been slow in 1968, with industrial production showing a year-to-year gain of only 2 per cent in the second quarter. The official forecast (in May) envisaged a 5.5 per cent increase in industrial production for 1968 as a whole over 1967, but it now looks as though this rate will not be achieved.

Japanese industrial production has again been advancing rapidly, following a moderate slackening in the first quarter. In July, as in the second quarter, output was running 19 per cent higher than a year earlier. Final demands, particularly for private consumption and for equipment investment, have been strong. Inventory investment diminished in the second quarter, when there was an absolute decline in stocks of raw materials and less rise in manufacturers' finished product inventories than there had been in each of the three preceding quarters.

The slackening of growth earlier this year had been due mainly to the tight money measures initiated in mid-1967 and strengthened in early January. A major factor in the resumption of rapid growth in the spring was the strong demand for Japanese exports, especially in the United States. Also, with imports level during the first half, Japan's balance of payments improved and permitted some easing of monetary policy.

After a period of virtually no expansion in the second half of 1967, the Canadian economy experienced moderate growth in the first half of 1968. Real gross domestic product in the second quarter was about 2.3 per cent higher than in the last quarter of 1967 -- an increase at about a 4-1/2 per cent annual rate. The economy continued to be plagued, however, by uncomfortably high rates of unemployment on the one hand and price rises on the other. As a result of unusually rapid labor force growth, the unemployment rate increased steadily in the first half and reached 5.1 per cent in August, compared to 4.0 per cent a year earlier. The consumer price index in August was 3.4 per cent higher than a year earlier.

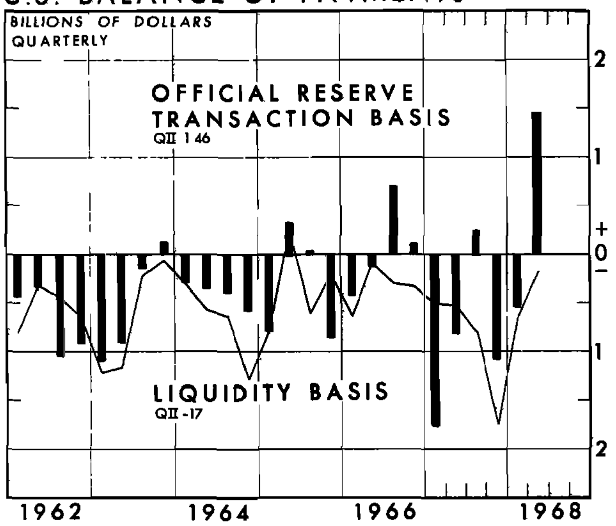
In Canada, as in Italy and Japan, exports were the leading factor in demand expansion. For the January-August period exports were 17 per cent higher than a year ago, despite a sharp decline in exports of wheat. The increase in exports was accounted for nearly entirely by a 26 per cent increase in sales to the U.S. A drop in U.S. imports in the coming months as a result of the widely expected slowdown in the U.S. economy would have marked short-run effects on the Canadian economy as there is little prospect of significant expansion in other expenditure sectors, except for strong growth in housing outlays.

Since the easing of the Canadian dollar crisis in the second quarter, interest rates have fallen markedly. Long term government bond rates have fallen by about 1/2 per cent and Treasury bill rates by about 1-1/2 per cent. The money supply began to increase rapidly in April, and by early September was 13.5 per cent above a year ago.

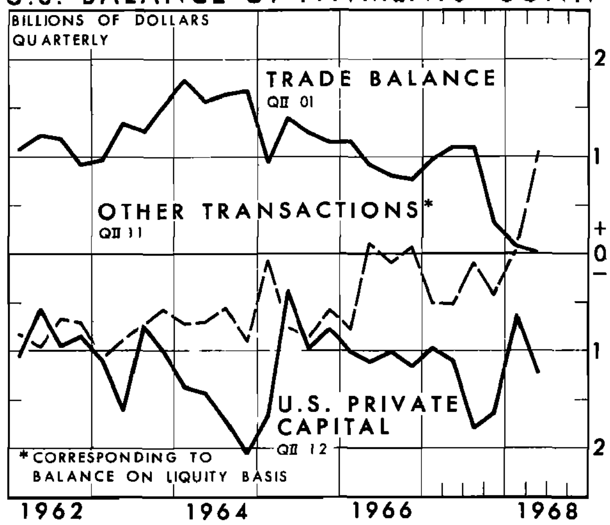
U.S. AND INTERNATIONAL ECONOMIC DEVELOPMENTS

SEASONALLY ADJUSTED

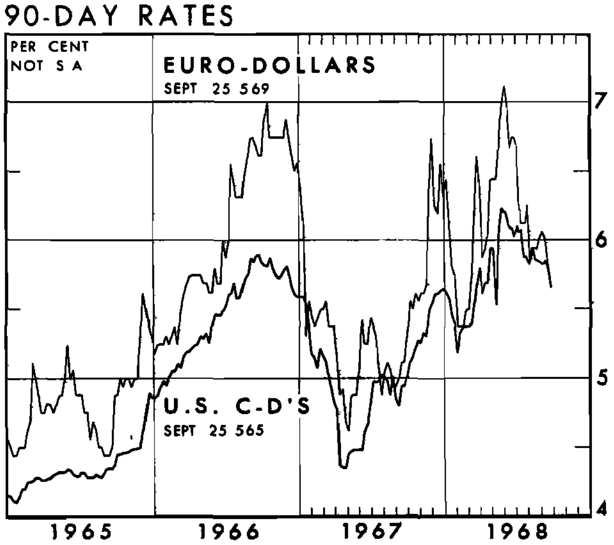
U.S. BALANCE OF PAYMENTS



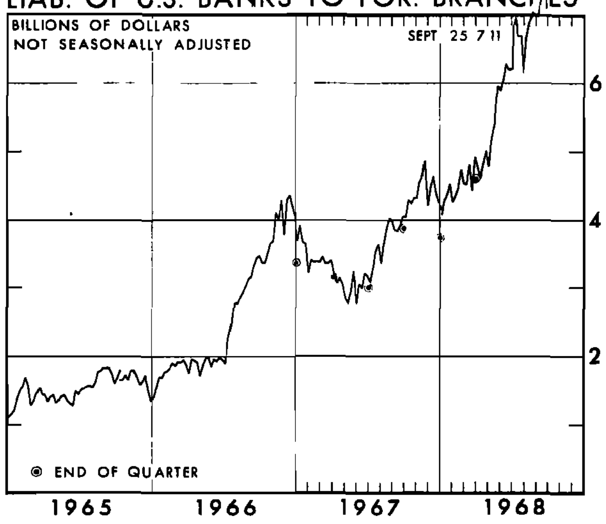
U.S. BALANCE OF PAYMENTS—CONT.



90-DAY RATES

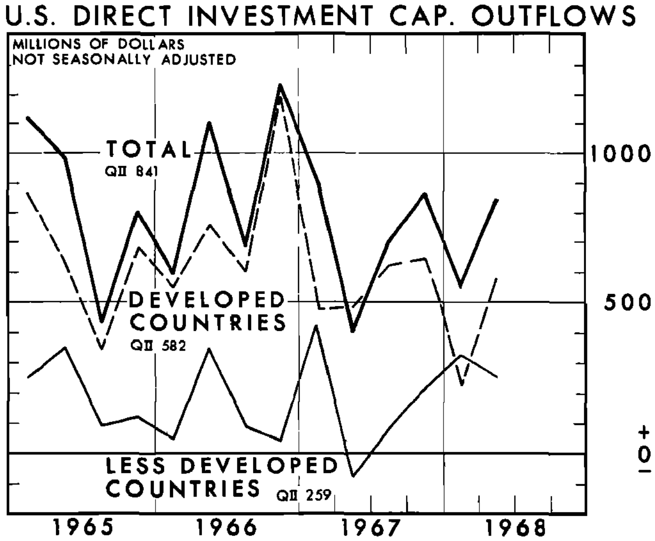


LIAB. OF U.S. BANKS TO FOR. BRANCHES



U.S. MERCHANDISE TRADE

U.S. DIRECT INVESTMENT CAP. OUTFLOWS



APPENDIX A: SUMMER REVIEW OF THE FEDERAL BUDGET*

The Budget Bureau in the Summer Budget Review released on September 12 made the following summary adjustments in its view of the likely budget outcome for fiscal 1969.

FISCAL YEAR BUDGET TOTALS
(Billions of dollars)

	Fiscal 1968	Fiscal 1969	
		Jan. est.	Summer review
Expenditures	173.0	18 .8	182.3
Net lending	5.9	3.3	2.1
Total outlays	178.9	186.1	184.4
Total receipts	153.5	178.1	179.4
Deficit	25.4	8.0	5.0

While the Summer Review revises the estimate of fiscal year receipts upward by $1.3 billion--to take account of tax legislation which shifted some revenues from fiscal 1968 to fiscal 1969, its major focus is on adjustments in spending. For the most part these reflect the spending constraints introduced by the Revenue and Expenditure Control Act, passed in late June. Allowance has also had to be made, however, for sizeable increases beyond January forecasts in crop purchases by the Commodity Credit Corporation and in public assistance grants, chiefly payments for Medicaid.

Despite the $6 billion spending cut required by the new law, estimated budget outlays for fiscal 1969 have been reduced by only $1.7 billion from the January forecast. The failure to produce a more significant cut reflects increases beyond January forecasts in the four key programs exempted from the act's expenditure ceiling. The net effect of these diverse adjustments in the overall spending forecast is shown in the table.

* Prepared by Mary Ellen Byrn, Research Assistant, Government Finance Section.

SPENDING CHANGES IN SUMMER BUDGET REVIEW
(Billions of dollars)

Total Federal outlays--January, 1968 budget estimate		186.1
Plus: Estimated increases for programs exempt from expenditure control		4.4
Vietnam support operations	2.3	
Interest	.9	
Social security trust funds	.7	
Veterans benefits	.4	
Plus: Selected increases in programs not exempt		1.2
Farm price support purchases (CCC)	.7	
Public assistance grants (including Medicaid)	.5	
Less: Budget cuts		(-) 7.2
Department of Defense, military and military assistance	3.0	
Net lending	1.2	
All other expenditures	3.0	
Equals: Federal outlays--Summer budget review		184.4

It is difficult at this point to evaluate the overall reasonableness of these summary estimates on changes in spending. Special question has already been raised by some analysts regarding the reasonableness of the $2.3 billion increase projected for Vietnam support operations. Two leading indicators of defense spending, obligations and contract awards, suggest that without a sharp near-term reduction in defense contracting, total defense spending for fiscal 1969 is likely to be $80 billion. This would be $2.5 billion more than projected in the Summer Review, and hence would raise the estimate of change in Vietnam support spending to $4.8 billion.

Since the Summer Budget Review was released, Budget Director Zwick has also indicated that CCC spending is now expected to exceed the January forecast by $900 million rather than the $700 million shown in the preceding table. At the same time, however, the Senate has voted to add CCC spending to programs exempted from the spending cut--presumably because such outlays reflect legislative provisions and are not subject to executive discretion. The Senate has also voted to cut spending for Medicaid by $500 million. In effect, this decision would disallow all of the estimated increase in spending for this program, forcing the states to cover the resultant shortfall in funds or cut back the size of payments. It is not yet clear whether the House of Representatives will go along with these Senate changes, particularly with regard to the Medicaid program where complaints from the states have already been voluble. If the Senate changes are not accepted, however, the required cut-back of Federal spending in all non-exempted programs would be $7.4 billion--the $6 billion originally legislated, plus the $1.2 billion of added CCC and Medicaid spending, shown in the Summer Review, plus the $200 million of further CCC outlays recently projected by Mr. Zwick.

The exact allocation of these spending cuts has not been fully determined, since several pending appropriations bills have yet to receive final Congressional approval. But for planning purposes, the Summer Budget Review assumes that Congressional and Administration cuts together will be distributed about as follows:

EXPECTED DISTRIBUTION OF STATUTORY SPENDING CUT

Program		Amount of Reduction (In billions)
Defense other than Vietnam support		$3.0
Lending programs		1.2
Other programs		3.2
Agriculture	0.9	
Non-exempted HEW programs	0.5	
Interior	0.4 1/	
Transportation	0.3	
NASA	0.3	
Foreign aid	0.2	
All other	0.6	
Total		7.4

1/ Reflects in part an increase in the estimate of returns from mineral leases on the Continental Shelf. Such returns appear in the budget as a negative expenditure.

As the table shows, a key part of the projected spending cut has been allocated to various lending programs. A third of a billion dollars will be cut from the Export-Import Bank's net lending because many new loans will be financed by selling seasoned portfolio loans to private investors. The Small Business Administration will substitute guaranteed bank loans for direct lending to reduce its outlays on the budget accounts. And the Farm Credit Administration is expected to cut back its lending program to 10 per cent of the fiscal 1968 total, partly because CCC payments have lowered the need for such lending. Loans made by the Federal National Mortgage Association will not be included in the federal accounts after it "goes private" on October 1, three months earlier than anticipated in the January budget documents; but since FNMA has been making more loans than projected in January, these two unanticipated influences are about offsetting and will have little budget impact.

While Congress is in session, the size and effective scope of the mandatory budget cut could, of course, change further, thereby causing corresponding shifts in the Administration's plans. The foregoing represent the most likely assignments for spending cuts throughout the Budget.

APPENDIX B

MEASURES OF THE U.S. BALANCE OF PAYMENTS AND SELECTED "SPECIAL" TRANSACTIONS
(millions of dollars) 1/

		1967 YEAR	1968 QI	1968 QII	1968 July	1968 Aug.	1968 Sept.
	1. Liquidity balance, NSA (deficit -)	-3,571	-249	+133	-208	-403	n.a.
	Seasonal adjustment		-411	-303			
	Liquidity balance, SA		-660	-170			
	2. SELECTED "SPECIAL" TRANSACTIONS						
	A. Investments in long-term deposits:						
	By foreign governments 2/	+920	+135	+144	-126	+109	+42
	By international and regional institutions	+187	-55	+17	-22	--	+2
	B. Investments in U.S. Gov't Agency Securities:						
*	By foreign governments 2/	+28	+10	+4	--	--	--
	By international and regional institutions	+120	-39	-42	+2	--	+65
	C. U.K. official transactions:						
	Long-term deposits	-72	-16	--	--	--	--
*	Liquidation of U.S. securities other than Treasury issues	-439	--	--	--	--	--
	D. Canadian Gov't transactions						
	Long-term deposits	--	--	--	--	--	--
	Net purchases of nonmarketable, nonconvertible U.S. Gov't. Securities	+170	+100	+500	--	--	--
*	Other	+30	-35	-72	--	--	--
	E. Nonscheduled debt repayment	+6	+42	--	--	+41	--
	F. Transactions in nonmarketable, nonconvertible U.S. Gov't. Securities 2/	+243	+115	+252	+14	+125	+267
	(of which are German transactions)	(+250)	(+125)	(+250) 3/	--	(125)	--
	TOTAL SELECTED "SPECIAL" TRANSACTIONS	+1,193	+257	+803	-132	+275	+376
	3. LIQUIDITY DEFICIT BEFORE REDUCTION BY "SPECIAL" TRANSACTIONS	-4,764	-917	-973	-76	-678	n.a.
	4. Official settlements balance, NSA (deficit -)	-3,405	+94	+1,561	-73	-17	n.a.
	Seasonal adjustment		-629	-102			
	Official settlements balance, SA		-535	+1,459			
	5. "SPECIAL" TRANSACTIONS AFFECTING OFFICIAL SETTLEMENTS BALANCE (Items marked * above)	-375	+17	-68	--	+41	--
	6. OFFICIAL SETTLEMENTS BALANCE BEFORE REDUCTION BY "SPECIAL" TRANSACTIONS	-3,030	-552	+1,527	-73	-58	n.a.

1/ Figures may not add because of rounding
2/ Excluding the U.K. and Canada

3/ $125 million of which was sold to German commercial banks, thus affecting both measures of the U.S. Balance of Payments